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# INSURANCE RECIPROCITY AND UNIFORMITY

NAIC and State  
Regulators Have Made  
Progress in Producer  
Licensing, Product  
Approval, and Market  
Conduct Regulation,  
but Challenges Remain





Highlights of [GAO-09-372](#), a report to congressional requesters

## Why GAO Did This Study

Because the insurance market is a vital part of the U.S. economy, Congress and others are concerned about limitations to reciprocity and uniformity, regulatory inefficiency, higher insurance costs, and uneven consumer protection. GAO was asked to review the areas of (1) producer licensing, (2) product approval, and (3) market conduct regulation in terms of progress by NAIC and state regulators to increase reciprocity and uniformity, the factors affecting this progress, and the potential impacts if greater progress is not made. GAO analyzed federal laws and regulatory documents, assessed NAIC efforts, and interviewed industry officials.

## What GAO Recommends

GAO recommends that, as Congress considers changes to its oversight of the insurance industry, it explore ways to ensure all states and jurisdictions can conduct nationwide criminal background checks as part of their producer licensing and consumer protection functions. GAO also recommends that NAIC and state insurance regulators work with the insurance industry to identify product approval differences among state regulators and improve how consistently state regulators review and approve product filings once received through SERFF.

NAIC generally agreed with GAO's recommendation, and provided additional comments on a number of issues associated with insurance regulation in general.

To view the full product, including the scope and methodology, click on [GAO-09-372](#). For more information, contact Orice M. Williams at (202) 512-8678 or [williamso@gao.gov](mailto:williamso@gao.gov).

# INSURANCE RECIPROCITY AND UNIFORMITY

## NAIC and State Regulators Have Made Progress in Producer Licensing, Product Approval, and Market Conduct Regulation, but Challenges Remain

### What GAO Found

Reciprocity of producer licensing among states has improved, but consumer protection and other issues present challenges to uniformity and full reciprocity. Congress' passage of the Gramm-Leach-Bliley Act (GLBA) in 1999, NAIC's Producer Licensing Model Act (PLMA) of 2000, and uniform licensing standards (2002) have helped improve reciprocity and uniformity. However, NAIC officials noted that as of March 2009, only 17 states were performing full criminal history checks using fingerprinting, and some states that do such checks have been unwilling to reciprocate with states that do not. In addition, some insurance regulators in our sample noted that regulators do not have a systematic way to access disciplinary records of other financial regulators. Without full checks on applicants, states may less effectively protect consumers. Licensing standards, including how state regulators define lines of insurance, also vary across states, further hindering efforts to create reciprocity in agent licensing. These differences may result in inefficiencies that raise costs for insurers and consumers.

State regulators' processes to approve insurance products have become more efficient, but barriers exist to greater reciprocity and uniformity. NAIC and state regulators have improved product approval filings by creating the System for Electronic Rate and Form Filing (SERFF) in 1998, which, according to some industry participants, has simplified filings and reduced filing errors. However, SERFF does not address differences in regulators' review and approval processes. In addition, an Interstate Compact was created in 2006 to facilitate approval of certain life, annuity, disability income, and long-term care products, which are accepted across participating states. As of March 2009, 34 states participated in the Compact. However, the Compact leaves some decisions on approval up to the individual states, and several key states have not joined because they feel their processes and protections are superior to the Compact's. Moreover, differences in state laws are likely to limit reciprocity in the approval of property/casualty insurance products. To the extent these areas lack reciprocity and uniformity, some industry participants noted that there may be inefficiencies that slow the introduction of new products and raise costs for insurers and consumers.

NAIC and the states have taken steps to improve reciprocity and uniformity of market conduct regulation, but variation across states has limited progress. For example, NAIC noted that in 2006 it developed uniform guidance, and in 2008 created core competency standards, which are intended to be part of an accreditation process for market conduct regulation. NAIC noted that the accreditation plan has not been finalized, and the standards do not include adherence to all NAIC market conduct guidance. In addition, NAIC in 2002 developed the Market Conduct Annual Statement (MCAS) to promote uniform data collection and better target exams. However, industry participants have several concerns about the MCAS and NAIC noted that fewer than half of insurance regulators use it for data collection. NAIC has also created a working group to coordinate enforcement actions. While better communication and coordination appears to have resulted, according to some states in our sample, the effect on uniformity of market conduct regulation is uncertain. Lack of uniformity and reciprocity may lead to inefficiencies, higher insurance costs, and uneven consumer protection across states.

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## Abbreviations

AIG	American International Group, Inc.
GLBA	Gramm-Leach-Bliley Act
IIPRC	Interstate Insurance Product Regulation Commission
MARS	Market Analysis Review System
MAWG	Market Analysis Working Group
MCAS	Market Conduct Annual Statement
MITS	Market Initiative Tracking System
NAIC	National Association of Insurance Commissioners
NARAB	National Association of Registered Agents and Brokers
NCOIL	National Conference of Insurance Legislators
PLMA	Producer Licensing Model Act
RIRS	Regulatory Information Retrieval System
RMBS	Residential mortgage-backed securities
SAD	Special Activities Database
SERFF	System for Electronic Rate and Form Filing
URLS	Uniform Resident Licensing Standards

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GAO

Accountability \* Integrity \* Reliability

United States Government Accountability Office  
Washington, DC 20548

April 6, 2009

The Honorable Spencer Bachus  
Ranking Member  
Committee on Financial Services  
House of Representatives

The Honorable Paul E. Kanjorski  
Chairman  
The Honorable Scott Garrett  
Ranking Member  
Subcommittee on Capital Markets,  
Insurance, and Government  
Sponsored Enterprises  
Committee on Financial Services  
House of Representatives

A smoothly functioning insurance market that helps businesses and consumers manage their risks is a vital part of the U.S. economy. According to the National Association of Insurance Commissioners (NAIC), at the end of 2008, insurance industry premium volume totaled approximately \$1.6 trillion in the 50 states and in the territories.<sup>1</sup> Though state insurance regulation involves a number of critical functions, including oversight of insurers' financial solvency, some Members of Congress and industry participants are concerned about limitations to reciprocity and uniformity, higher insurance costs, regulatory inefficiency, and uneven consumer protection. Reciprocity is the extent to which state regulators accept other states' regulatory actions, such as granting insurance licenses or approving products for sale in the insurance market, and do not require insurers to meet additional requirements in order to conduct insurance business in their state. Uniformity is the extent to which states have implemented either the same, or substantially similar, regulatory standards and procedures. Though state insurance regulation

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<sup>1</sup>The National Association of Insurance Commissioners (NAIC) is the organization of insurance regulators from the 50 states, the District of Columbia, and the five U.S. territories. NAIC assists state insurance regulators in achieving insurance regulatory goals including protecting the public interest, promoting competitive markets, facilitating fair and equitable treatment of insurance consumers, promoting the reliability, solvency and financial solidity of insurance institutions, and supporting and improving state regulation of insurance.

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involves a number of critical functions, including oversight of insurers' financial solvency, many of the questions about the extent of reciprocity and uniformity of regulation across states have involved the areas of licensing insurance agents (producer licensing), approving insurance products, and regulating insurers' conduct in the insurance market (market conduct).

Questions concerning reciprocity and uniformity of state-based insurance regulation have persisted for a number of years. In 1999, Congress passed the Gramm-Leach-Bliley Act (GLBA), which encouraged states to enact uniform laws and regulations for licensing insurers or reciprocity among states when licensing insurers that operate across state lines.<sup>2</sup> In response to the act, NAIC developed a model law to streamline and standardize producer licensing requirements and help states become more reciprocal. In addition, over the past 10 years we have made a number of recommendations in reports, listed in related GAO products, designed to help state regulators implement a consistent set of insurance regulations. Congress has also periodically considered the extent of insurance regulatory progress and the role the federal government should play, if any, in regulating insurance. For example, the National Insurance Act of 2007 would have established a national office of insurance, provided for optional federal insurance charters, and proposed creation of a comprehensive system of federal oversight.<sup>3</sup> In 2008, Congress considered establishing the National Association of Registered Agents and Brokers (NARAB) to ease multistate licensing processes by setting uniform licensing standards across states.<sup>4</sup> However, neither of these proposals became law. Additional questions about oversight of the insurance industry arose in 2008 when one of our nation's largest insurers, American International Group, Inc. (AIG), experienced financial difficulties. Securities lending activities undertaken by AIG's domestic life insurance subsidiaries placed pressure on the AIG parent company's liquidity, and in November 2008, the Federal Reserve Bank of New York authorized \$22.5

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<sup>2</sup>Gramm-Leach-Bliley Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999).

<sup>3</sup>National Insurance Act of 2007, H.R. 3200, 110th Congress (2007), and National Insurance Act of 2007, S. 40, 110th Congress (2007).

<sup>4</sup>National Association of Registered Agents and Brokers Reform Act of 2008, H.R. 5611, 110th Congress (2008).

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billion for a credit facility to purchase residential mortgage-backed securities from AIG that were part of the securities lending program.<sup>5</sup>

In considering options to best ensure efficient and effective state-based regulation of insurance, Congress has had a number of questions about the success of recent efforts and the challenges that remain. To help policymakers better address these questions, as requested this report examines three key areas of the insurance industry: (1) producer licensing, (2) product approval, and (3) market conduct regulation.<sup>6</sup> In each area we assess the progress NAIC and state regulators have made to increase reciprocity and uniformity, the factors that have challenged efforts to achieve greater reciprocity and uniformity, and the potential impact on the insurance industry and consumers if greater progress is not made.

To assess insurance regulatory progress, challenges, and impacts, we compared insurance regulatory goals set forth in federal legislation, NAIC model acts and regulatory planning documents, and GAO reports. Specifically, we reviewed the insurance provisions of GLBA and NAIC's Producer Licensing Model Act (PLMA). We assessed regulatory documents such as NAIC's 2003 Insurance Regulatory Modernization Action Plan (Modernization Plan) and producer licensing, product approval, and market conduct regulation guidelines. We also interviewed insurance officials from a sample of nine state insurance departments, four insurance companies, five insurance associations, and three consumer advocacy organizations regarding reciprocity and uniformity progress and challenges. We selected these states based on diversity of premium volume size and geography. To assess regulatory progress and challenges, we relied on descriptions and other documentation provided by NAIC, states, insurers and associations, and consumer advocates.

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<sup>5</sup>The securities lending program allowed insurance companies, primarily the life insurance companies, to lend securities in return for cash collateral that was invested in residential mortgage-backed securities (RMBS). When the value of these securities declined in 2007, AIG incurred significant losses when it had to return the cash collateral when its borrowed securities were returned. Collateralized debt obligations are securities backed by a pool of bonds, loans, or other assets.

<sup>6</sup>According to NAIC, an insurance producer, also called an agent or insurance broker, is an individual licensed by a state's or jurisdiction's insurance division or department to sell, solicit or negotiate insurance in that state or jurisdiction. To become licensed, producers must take pre-licensing education in most states, successfully pass an insurance licensing exam, and pay all licensing fees. A licensee must then complete ongoing continuing education courses on ethics, law, and product knowledge on a periodic basis.

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We conducted this performance audit between February 2008 and April 2009 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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## Results in Brief

Reciprocity of producer licensing among states has improved, but limited fingerprint-based background checks and differences in state licensing requirements and insurance line definitions present challenges to both full reciprocity and uniformity. Increased reciprocity and uniformity have been goals of Congress, NAIC, state insurance regulators, and insurers for a number of years. In 1999, Congress passed GLBA, which encouraged at least 29 states to meet reciprocity or uniformity conditions within 3 years of the act's passage in order to avoid preemption of certain state producer licensing laws and the potential formation of a federal regulatory body for insurers. To help meet the requirements of the act, NAIC developed the PLMA to promote a framework for reciprocal producer licensing relationships among states. In addition, NAIC created a uniform application for licensing so that insurance producers could use a single licensing application form rather than separate applications for each state or jurisdiction. While producer licensing has improved, full reciprocity and uniformity challenges remain. While criminal background checks are not required for reciprocal licensing arrangements between states, state insurance regulators have responsibility to review insurance applications and prevent criminals from being licensed. However, according to NAIC, only 17 state regulators as of March 2009 were performing full criminal history checks using fingerprinting on applicants and were doing so as part of their producer licensing programs. Uniformity is limited when states have inconsistent background check requirements, and some states that do such checks have been unwilling to reciprocate with states that do not. These regulators believe that they would be weakening the protections that background checks provide by accepting the licensing decisions of states that do not perform checks. Further, some insurance regulators in our sample noted that regulators have no systematic way to query the regulatory and disciplinary records of applicants that are maintained in separate information systems used by banking and securities regulators. Without thorough criminal and regulatory checks across states, regulators have been reluctant to reciprocate with other states on producer licensing. We also found that licensing standards, including definitions and numbers of lines of insurance, varied across



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states and also hindered reciprocity and uniformity.<sup>7</sup> These differences among states may result in inefficiency in licensing processes and higher costs for insurers and consumers.

The process for approving insurance products has become more efficient, but as with licensing, barriers exist to greater reciprocity and uniformity. NAIC's Modernization Plan, formulated in 2003, calls for greater uniformity and improving the timeliness and consistency of reviews given to insurers' filings for product approval. NAIC and state regulators have standardized the initial filing process by creating an automated system in 1998 called the System for Electronic Rate and Form Filing (SERFF), which is used for insurance product filing submission. While SERFF provided a uniform way for insurers to submit product filings, states' different processes for reviewing and following up on filings may involve different procedures and approaches, and some states may require varying levels of additional documentation on products that may work against uniformity. In addition, according to NAIC, many state regulators participate in an Interstate Insurance Compact (the Compact), created in 2006, that established a multistate public entity, the Interstate Insurance Product Regulation Commission (IIPRC). The commission approves certain life, annuity, disability income, and long-term care insurance products that are then accepted for sale in the participating states. According to NAIC, as of March 2009, 34 states were participating in the Compact. However, while the Compact has improved product approval uniformity and reciprocity among participating states and jurisdictions, according to some industry participants, it leaves some product approval decisions up to the individual states. For example, the Compact allows participating states to determine whether to allow fraud exceptions to life insurance policy incontestability clauses, which are designed to protect insurers from inaccurate policyholder information and consumers from coverage denials. According to some industry participants, uniformity will be difficult to achieve if states have the ability to make individualized decisions that do not apply across multiple states. In addition, several key states, including California and Florida, have not joined the Compact because, according to industry officials, their product approval standards are more stringent than those of the Compact. Finally, according to some industry participants, full reciprocity in the approval of property/casualty

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<sup>7</sup>Lines of insurance refer to the different types of insurance insurers generally offer for sale to consumers. The NAIC categorizes insurance according to the following groups: property, casualty, variable life and variable annuity, life, personal lines, and accident or health and sickness.

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insurance products is unlikely to occur because of differences in these products across states and because of differences in state laws. For example, NAIC noted that laws regarding responsibility for payment of, and limits to, damages differ across states, and property/casualty policies must conform to these laws. Ultimately, to the extent that reciprocity and uniformity are lacking in these areas, the result may be inefficiencies that inhibit the introduction of new insurance products and raise costs for insurers and consumers.

NAIC and the states have taken steps to improve market conduct regulation, but variations across states have limited progress toward reciprocity and uniformity.

- To create common market analysis standards and promote more uniform market conduct programs across states, NAIC and state regulators established a Modernization Plan in 2003 to give insurance regulators a guide and series of goals for improving reciprocity and uniformity of insurance oversight across states.
- To provide state regulators with uniform guidance and standards, NAIC created a set of 99 core competency standards in 2008 intended to be part of a proposed market conduct accreditation program. NAIC also produced the *Market Regulation Handbook (Handbook)* in 2006, which brought together market analysis and examination guidance. In addition, NAIC developed a uniform market conduct examination outline in 2002 to improve uniformity of examination processes.<sup>8</sup> However, NAIC officials also noted that, as of March 2009, the accreditation plan had not yet been finalized and that the core competency standards did not include specific guidance for conducting market conduct examinations. Implementation of the *Handbook* has varied across states as some regulators reported using it only to the extent that it was consistent with state laws, regulations, and regulatory priorities.
- To standardize market conduct data collection and analysis, NAIC and state regulators created the Market Conduct Annual Statement (MCAS). According to NAIC, as of March 2009, 29 states were committed to collecting MCAS data, but these and other states and industry groups had not reached a consensus on what data should be collected, whether the

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<sup>8</sup>State insurance regulators may conduct examinations of insurance companies to be sure that the companies doing business within their states comply with state laws and regulations with respect to rating, underwriting, and claim practices. These market conduct examinations may be scheduled based on consumer complaint activity, special requests, or at regular intervals.

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information should be available to the public, and who should store and manage it.

- In addition, NAIC created a working group to coordinate market conduct enforcement actions, target issues, and increase collaboration across states. According to some states in our sample, although the market conduct working group appears to have resulted in better information sharing and coordination of multistate collaborative initiatives, the group's impact on uniformity is not yet clear.

In addition, according to NAIC, while NAIC and the National Conference of Insurance Legislators (NCOIL) developed a model law in 2004 designed to promote uniformity of state market conduct activities, as of March 2009, only one state had passed the model law. According to NAIC officials, only one state passed the model law because it would have restricted their ability to regulate their respective insurance markets as they saw fit. Differences across states in their market conduct regulation limit the uniformity and reciprocity of their efforts, which in turn, can lead to inefficiencies for regulators and insurers and uneven consumer protection across states.

This report contains one matter for congressional consideration and one recommendation designed to strengthen states' oversight of insurance. To improve state insurance regulators' ability to protect consumers by identifying insurance license applicants with criminal backgrounds, as part of its insurance oversight practices, Congress should explore ways to ensure that all states and jurisdictions can conduct nationwide criminal background checks as part of their producer licensing and consumer protection functions. In addition, we recommend that NAIC and state regulators work with the insurance industry to further identify differences in the ways state regulators review and approve filings received through SERFF, and take any necessary steps, where appropriate, to improve consistency in their product approval processes.

We provided a draft of this report to NAIC. The Chief Operating Officer and Chief Legal Officer of NAIC provided written comments which are reprinted in appendix II. NAIC generally agreed with the recommendation in the report and stated that their efforts to improve the reciprocity and uniformity of state insurance regulation will continue. NAIC also noted that while the areas on which the report focuses—producer licensing, product approval, and market conduct regulation—are important, other regulatory areas, such as financial solvency regulation, are also critical. NAIC also noted that in certain areas, reciprocity and uniformity may not

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be appropriate. NAIC's comments, as well as our responses, are summarized at the end of this report.

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## Background

Insurers, state insurance regulators, and NAIC all have roles that are important to the continued functioning of the insurance sector and to U.S. consumers and businesses.

- Insurers provide services that allow individuals and businesses to manage risk by providing compensation for certain losses or expenses, such as car crashes, fires, medical services, or inability to work. Some insurers also provide access to certain financial services, such as annuities and mutual funds.
- State insurance regulators are responsible for enforcing state insurance laws and regulations, including through the licensing of agents, the approval of insurance products and their rates, and the examination of insurers' financial solvency and market conduct. State regulators typically conduct financial solvency examinations every 3 to 5 years, while market conduct examinations are generally done in response to specific consumer complaints or regulatory concerns. State regulators also monitor the resolution of consumer complaints against insurers.
- NAIC is a voluntary association of the heads of insurance departments from the 50 states, the District of Columbia, and five U.S. territories.<sup>9</sup> While NAIC does not regulate insurers, it does provide services designed to make certain interactions between insurers and regulators more efficient. These services include providing detailed insurance data to help regulators understand insurance sales and practices; maintaining a range of databases useful to regulators; and coordinating regulatory efforts by providing guidance, model laws and regulations, and information-sharing tools.

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<sup>9</sup>The five territories are Puerto Rico, Guam, U.S. Virgin Islands, American Samoa, and Northern Mariana Islands.

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## States Oversee the Insurance Industry through Producer Licensing, Product Approval, and Market Conduct Regulation Functions, among Others

Insurance companies are regulated by the states, unlike the banking and securities industries, which are regulated under a dual federal-state oversight system.<sup>10</sup> In addition to critical functions such as oversight of insurers' financial solvency, state insurance regulation involves key regulatory processes, including: licensing insurance producers, including insurance agents, brokers, and companies; reviewing and approving insurance products and rates; and reviewing and examining insurers' market conduct.

- Licensing producers consists of reviewing license applications to sell insurance products, reviewing applicants' criminal and regulatory background, if any, and approving or denying applications and issuing licenses.
- During product approval processes, regulators review insurers' products and rates, in some cases, before they enter the market for sale to consumers. Regulators review policy forms, which are legal contracts that describe the characteristics of the products insurers intend to sell and the rates or prices they intend to charge, and then grant or deny product approval. Not all products are subject to prior approval.
- Regulators' market conduct oversight involves protecting consumers by monitoring and examining the conduct of insurance producers. To fulfill this role, state regulators analyze information that they periodically collect on the marketing and sales behavior of insurers in order to identify any problems. Regulators also conduct periodic market conduct examinations to investigate insurers' market behaviors in greater depth. Regulators may issue findings and work with insurers on corrective actions identified as a result of market analysis and market conduct examinations.

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## NAIC Assists State Regulators with a Variety of Oversight Functions

NAIC assists state regulators in their efforts to oversee the insurance industry and serves regulators with a variety of functions. While NAIC does not have regulatory authority over state insurance departments, it collects, stores, and analyzes detailed insurance data to help regulators understand insurance sales and practices. NAIC data and databases provide information that regulators can use during their producer licensing, product approval, and market conduct processes. NAIC also

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<sup>10</sup>The federal government retains the authority to regulate insurance under the constitution's commerce clause and has given primary responsibility for insurance regulation to the states in accordance with the McCarran-Ferguson Act of 1945. 15 U.S.C. §§ 1011-1015.

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helps states coordinate regulatory efforts by providing guidance, model and recommended laws and regulations, and information-sharing tools. State legislatures may implement NAIC's model laws by passing model laws or substantively similar legislation in the states.

NAIC generally operates through a system of working groups, task forces, and committees made up of state regulators and NAIC officials that identify issues, facilitate interstate communication, and propose regulatory improvements. These entities meet periodically to discuss issues, build consensus on reforms, and vote to adopt new standards, model laws, and model regulations. These processes are cooperative but often take months or years to complete because of the number of participants and diversity of priorities involved. In addition to these functions, NAIC also developed and implemented a financial accreditation program in 1990 to periodically review state insurance departments for baseline financial solvency oversight standards. Accreditation standards require state insurance departments to have adequate statutory and administrative authority to regulate insurers' corporate and financial affairs. NAIC is considering, but has not yet developed, an accreditation program for regulation of insurers' market conduct.

In 2003, NAIC created its Modernization Plan to highlight areas in which NAIC and state regulators planned improvements for oversight of the insurance industry. The plan reinforced the primary goals of protecting consumers and creating a competitive and responsive insurance market. For producer licensing, the plan sought to implement a uniform electronic licensing system for individuals and business entities that sell insurance. The Modernization Plan specifically called for implementation of a single, uniform license application and full implementation of an electronic fingerprint system as part of the licensing process. For product approval, NAIC and state regulators planned to fully implement and use SERFF for product filings. They also planned to develop an interstate compact to provide a central point of filing for certain life and annuity products that would be accepted across states and would feature uniform national product standards. For market conduct regulation, the plan noted the need for a common set of standards for uniform market regulatory oversight that includes all states. In particular, it called for each state to adopt uniform market analysis standards and procedures, improve interstate collaboration, and integrate market analysis with other key regulatory functions.

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## GAO Has Issued a Number of Reports on Insurance Regulation

Since 2000, we have issued a number of reports on state regulators' oversight of the insurance industry, including reports on improving regulatory efficiency, uniformity, and reciprocity in the areas of producer licensing, product approval, and market conduct regulation. We have made numerous recommendations to the NAIC and states concerning the lack of full criminal background checks by insurance regulators during licensing processes, the need for more uniform product approvals across states, and the difficulties insurance regulators face for sharing information, including with regulators from other parts of the financial services sector. NAIC generally concurred with these recommendations, and stated that they would take steps to address them. These reports have also recognized the importance of establishing uniform minimum market conduct standards that are consistently used across states. See Related GAO Products for a list of relevant insurance reports that we issued between 2000 and 2008.

In a recent report looking at the broader financial regulatory system, we developed a framework for assessing the strengths and weaknesses of proposals for regulatory modernization that included a number of goals relevant to a discussion of reciprocity and uniformity of insurance regulation.<sup>11</sup> Specifically, any financial regulatory system should for example:

- be flexible and able to readily adapt to innovations and changes;
- be efficient and effective, eliminating overlap and minimizing regulatory burden while effectively achieving regulatory goals;
- provide consumers with consistent protections for similar financial products and services, including sales practice standards; and
- provide consistent financial oversight, with similar institutions, products, risks, and services subject to consistent regulation, which would harmonize oversight within the United States and internationally.

In addition, we reported that given the difficulties to harmonize insurance regulation across states through the NAIC-based structure, Congress could consider the advantages and disadvantages of providing a federal charter option for insurance and creating a federal insurance regulatory entity.

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<sup>11</sup>GAO, *Financial Regulation: A Framework for Crafting and Assessing Proposals to Modernize the Outdated U.S. Financial Regulatory System*, [GAO-09-216](#) (Washington, D.C.: Jan. 8, 2009).

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## Producer Licensing Reciprocity Has Improved, but Full Reciprocity and Uniformity Challenges Remain

NAIC and state regulators have taken steps to increase reciprocity in producer licensing across states, but challenges remain. Increased reciprocity and uniformity have been goals for Congress, NAIC, state insurance regulators, and insurers for a number of years, especially since passage of GLBA in 1999. Following passage of the act, NAIC and state regulators worked to develop the PLMA and various NAIC and state licensing standards. According to NAIC, since GLBA, most states have passed and implemented the PLMA, which set licensing standards for states to follow in order to meet reciprocity and uniformity requirements. However, the small number of states performing full producer background checks with fingerprinting remains a barrier to greater reciprocity and uniformity. States that perform the checks may be unwilling to reciprocate with those that do not for fear of compromising their consumer protection laws. In addition, different licensing requirements and insurance line definitions across states have also limited reciprocity and uniformity.<sup>12</sup> A lack of reciprocity and uniformity in producer licensing could lead to regulatory inefficiencies, higher insurance costs, and uneven consumer protections.

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## Increased Reciprocity and Uniformity Have Been Goals for at Least the Past Decade

GLBA's passage in 1999 and the subsequent development of the PLMA by NAIC and state regulators provided the framework and impetus for reciprocity and uniformity in producer licensing processes among states. If within three years of GLBA's enactment, at least 29 states did not either pass uniform or reciprocal laws and regulations governing the licensure of individuals and entities authorized to sell insurance, GLBA called for the preemption of certain state producer licensing laws and the potential formation of a federal regulatory body for insurers. Following passage of the act, NAIC and states elected to pursue the reciprocity option, with uniformity as a longer-term goal for producer licensing.

To help states meet GLBA's reciprocity requirements, NAIC developed PLMA to help address differences among states in the areas of defining insurance products and lines, agent licensing standards, and variations in state licensing applications. The act was intended to streamline and standardize producer licensing requirements across states and improve the efficiency of insurance licensing processes. To respond to state

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<sup>12</sup>NAIC's lines of insurance consist of property, casualty, life, personal lines, accident and health or sickness, and variable life/variable annuity. NAIC's limited lines of insurance consist of credit, car rental, crop, travel, and surety.



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differences in defining types or lines of insurance and general inefficiency in licensing processes, PLMA sought reciprocity and uniformity by specifying standard definitions for six major types or lines of insurance for use across states. The act also provided for reciprocal recognition across states of continuing education requirements for producers, another area in which state requirements had previously varied.

In addition, in 2002 NAIC developed the Uniform Resident Licensing Standards (URLS) to help states implement the reciprocity requirements of GLBA and PLMA. The URLS address some items that, according to NAIC officials, were not included in PLMA, such as definitions for limited lines of insurance. Further, the URLS provide the professional standards for industry entry and continuation of licensure for insurers, as well as administrative standards for regulators to achieve uniformity and increased efficiencies. These professional standards are segmented into broad categories:

- licensing qualifications standards,
- pre-licensing education requirements,
- integrity and personal background checks,
- application for licensure,
- the appointment process,
- continuing education requirements,
- limited lines, and
- surplus lines.

The background checks, in particular, call for states to fingerprint their new producers and conduct state and federal background checks on applicants. NAIC also developed the *Uniform Application for Individual Insurance Producer License*, which created a standardized application form that state regulators could use for insurance licenses. Use of the form helps ensure that regulators would have a single producer license application for use across states rather than multiple forms and documentation for individual states. In reports in 2002 and 2004 on insurance regulation, we noted that despite efforts made by NAIC and state regulators to implement GLBA and PLMA and create more uniform standards and processes, remaining differences among the states may limit

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full reciprocity and uniformity.<sup>13</sup> For example, we previously found that some states are not willing to lower producer licensing standards—such as eliminating criminal background checks using fingerprint identification—to allow for uniform or reciprocal licensing, and few states have the ability to access nationwide criminal history data necessary for full background checks on applicants. In addition, we found that state insurance regulators could improve consumer protection by sharing regulatory and complaint information between financial services regulators.

In 2003, NAIC developed its Modernization Plan to provide a roadmap for progress and centralize producer licensing and other regulatory goals, thus promoting uniformity and reciprocity among the states. The plan essentially incorporated the goals of the PLMA, the URLS, and the *Uniform Application*. The plan also specifically sought to promote producer licensing uniformity and reciprocity by calling for background checks on insurance license applicants using electronic fingerprinting. Not only would such checks provide uniform background reviews across states, but they were intended to help state regulators ensure consistently high levels of consumer protection. To achieve greater use of criminal background checks with fingerprinting, the Modernization Plan also called for efforts by NAIC and state insurance regulators to recognize the important role of federal and state legislatures to pass legislation that would provide state insurance regulators the appropriate statutory authority necessary for conducting such checks.<sup>14</sup>

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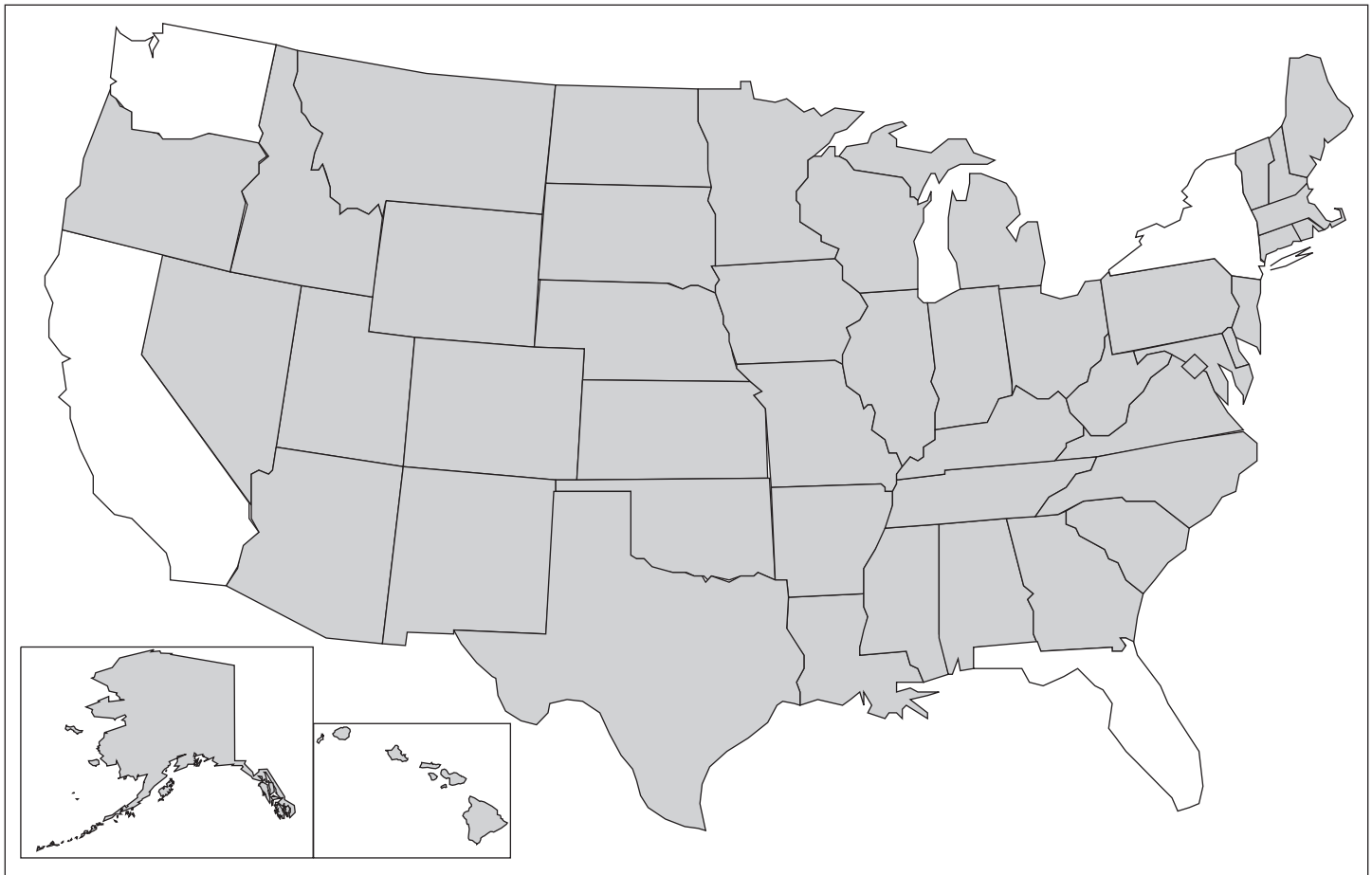
<sup>13</sup>GAO, *Better Information Sharing among Financial Regulators Could Improve Protections for Consumers*, [GAO-04-882R](#) (Washington, D.C.: June 29, 2004) and *State Insurance Regulation: Efforts to Streamline Key Licensing and Approval Processes Face Challenges*, [GAO-02-842T](#) (Washington, D.C.: June 18, 2002) specifically addressed producer licensing concerns.

<sup>14</sup>The FBI is authorized to exchange criminal history information with officials of state and local governmental agencies for licensing and employment purposes if authorized by a state statute that has been approved by the Attorney General of the United States. Pub. L. No. 92-544, 86 Stat. 1115 (1972), codified at 28 U.S.C. § 534 note.

## NAIC and States Have Made Progress on Regulatory Modernization Goals for Producer Licensing

As of March 2009, NAIC has certified 47 states and jurisdictions as reciprocal based on their adoption and implementation of PLMA, which is integral to achieving the reciprocity and uniformity envisioned by the Modernization Plan. Passage of PLMA and certification by NAIC suggest that these 47 states and jurisdictions have similar producer licensing processes and standards in place and are reciprocal in their treatment of insurers who wish to sell insurance products across those states. Figure 1 provides a map of states and jurisdictions NAIC has certified as reciprocal.

**Figure 1: Map of States and Jurisdictions NAIC Has Certified as Reciprocal for Producer Licensing, as of March 2009**



States certified by NAIC as reciprocal

Source: NAIC; Art Explosion (map).

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To be considered reciprocal for producer licensing in states beyond the home state where an initial license was granted, states must meet four conditions. First, states must permit producers with a license in their home state to sell insurance without satisfying any other additional requirements other than submitting:

- a request for licensure,
- the application used for licensure in the home state,
- proof of licensure and good standing in the home state, and
- any requisite fee.

Second, states must accept the home state's continuing education requirements. Third, states must not impose any other requirements for licensure that would limit insurance activities because of place of residence. And fourth, each state that meets these criteria must grant licensing reciprocity to insurers of all other states that also meet the criteria. NAIC certifies states as reciprocal based on the criteria above. Once certified as reciprocal, states have the continuing obligation to remain compliant, and NAIC has a continuing obligation to certify states' compliance.

According to NAIC officials, as of December 2008, all states were using the *Uniform Application* for non-resident applicants. Use of this form, according to NAIC and industry participants, has helped make licensing more uniform across states. Insurance industry officials said that the form has been of particular benefit to insurers with agents operating in multiple states, as they no longer are required to fill out different forms for each state.

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**Progress toward Reciprocity and Uniformity Has Been Limited and Some Barriers Exist to Further Progress**

While passage of PLMA and certification of 47 states and jurisdictions as reciprocal represent progress in the area of producer licensing, several key states such as New York, California, and Florida have not been certified by NAIC as reciprocal because they generally have not accepted the producer licensing standards of other states—a condition of certification. An NAIC official noted that reasons for a lack of full reciprocity and uniformity among states include conflict among existing state laws and legislative and industry opposition to full fingerprint-based criminal background checks. In addition, the certification process does not include a review of whether states are also complying with the URLS, which added some standards that were not included in PLMA but which NAIC believed were important

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The Small Number of States Performing Full Background Checks on Producers Is a Barrier to Reciprocity and Uniformity

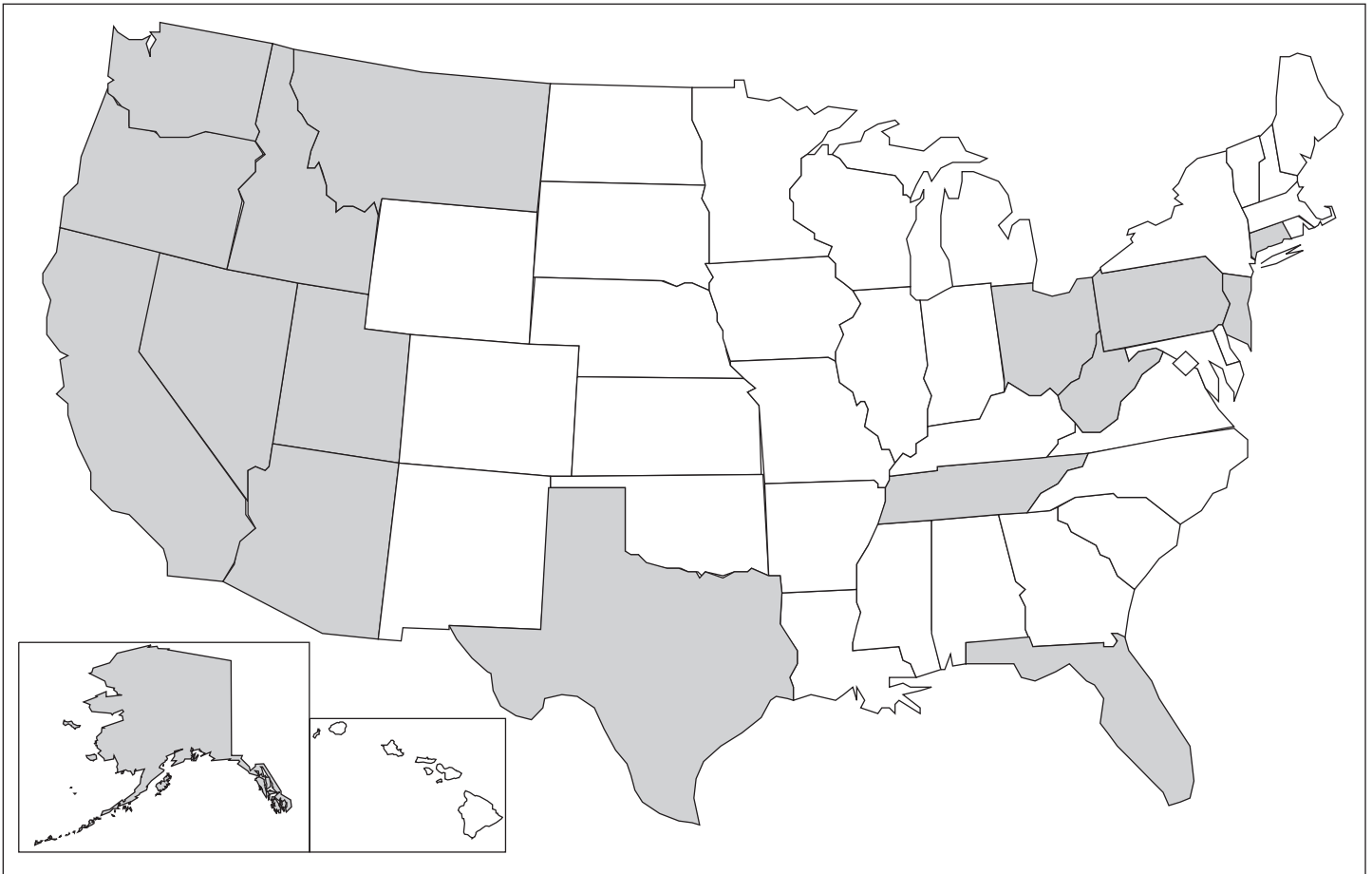
for meaningful uniformity and reciprocity. According to NAIC officials, they plan to incorporate these additional standards in future certification efforts. Other limits on or barriers to complete reciprocity and uniformity include the limited number of states performing fingerprint background checks and differences in state licensing requirements and insurance line definitions.

While criminal background checks are not required for reciprocal licensing arrangements between states, state insurance regulators have a responsibility to review insurance applications and prevent criminals from being licensed.<sup>15</sup> Though some state insurance regulators have sought authority to conduct full background checks using fingerprinting, NAIC officials noted that only 17 states as of March 2009 were performing full nationwide criminal history checks using fingerprinting as part of their licensing programs. With only 17 states performing such checks, reciprocity and uniformity of producer licensing across states may be limited when states that perform fingerprint checks do not accept licenses granted by states that do not perform such checks. Figure 2 is a map of states that conduct these background checks.

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<sup>15</sup>In addition to state insurance laws, 18 U.S.C. § 1033 provides that, among other things, a person who has been convicted of any criminal felony involving dishonesty or a breach of trust or any offense described in the section may engage in the business of insurance only through the written consent of an insurance regulatory official authorized to regulate the insurer.

**Figure 2: Map of States Performing Criminal Background Checks Using Fingerprinting, as of March 2009**



States that do criminal background checks with fingerprinting for producer licensing purposes

Source: NAIC; Art Explosion (map).

States unable to perform these checks generally cite lack of statutory authority as a primary reason. Specifically, state insurance regulators and other industry participants noted that regulators have had difficulty getting state legislatures to grant the authority for insurance departments to access the law enforcement databases needed to review applicants for nationwide criminal records. Some states and industry officials reported industry group opposition as a primary reason for lack of movement by legislatures to grant full background check authority and noted that further progress by the states without Congress granting such authority was unlikely. NAIC also noted that Federal Bureau of Investigation

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administrative standards related to fingerprinting have also been a barrier. Other states noted the importance of criminal background checks and mentioned that other entities like the Securities and Exchange Commission have the authority under federal law to conduct full background checks with fingerprinting as part of their process to license those who wish to sell securities products.

Officials from some of the states in our sample also noted that many states are unwilling to reciprocate with other states that do not conduct such checks and expressed concern that doing so would diminish their consumer protections. Without the ability to conduct full criminal background checks, state regulators are less likely to detect applicants with criminal background and deter them from obtaining licenses. State regulators' inability to thoroughly review applicants' regulatory background also hinders efforts to efficiently license applicants across multiple states.

Some insurance regulators from our sample noted that they have the ability to access NAIC databases such as the Regulatory Information Retrieval System (RIRS) and the Special Activities Database (SAD) to check applicants' background, but they reported being unable to systematically perform regulatory history checks by querying the disciplinary records of separate systems used by banking and securities regulators. Regulatory history checks by insurance regulators consist of efforts to determine whether insurance applicants have a history of consumer complaints or regulatory enforcement actions. Accessing this history may be difficult because banking, securities, and insurance regulators maintain regulatory background information in separate information technology systems. Some insurance regulators noted that no systematic query function or mechanism exists that would enable insurance and other regulators to check enforcement and complaint information in these separate systems in order to review information from across the three financial services sectors. Without the ability to share regulatory history data, insurance regulators may be less able to detect applicants with prior regulatory issues or histories of consumer complaints and prevent their entry into the insurance industry from other states or other parts of the financial services sector. Table 1 provides examples from the state of California of criminal convictions that were identified through fingerprint-based criminal background checks but that applicants for insurance licenses did not disclose on their insurance license applications.

**Table 1: Examples of Criminal Convictions Identified through Fingerprint-based Background Checks, but Not Self-reported by Insurance License Applicants**

Year of insurance application	Criminal conviction identified	Year of conviction
2008	Possession of controlled substance, misdemeanor	2006
2008	Battery against former spouse/fiance	2008
	DUI with blood alcohol content over 0.08 percent, and driving with suspended license	2004
	Battery, misdemeanor	2002
2007	Possession of a switch-blade, misdemeanor	2003
2007	Delaying, resisting, obstructing officer, felony	2006
	Failure to provide conviction adjudication percentage, felony	1999
	Possession of firearm by specified person, felony	1998
	Fight in a public place, misdemeanor	1994
2007	Grand theft, felony	1987
	Conspiracy, felony	1998
	Filing false or fraud claim payment, felony	1998
2007	Theft of property, misdemeanor	2007
	Trespass without consent	2007
2007	Giving false information to peace officer	2005
	Driving without valid license	2005
	Corporal injury to spouse, misdemeanor	1997
2006	Forgery, felony	2003

Source: State of California, Department of Insurance.

**Different Licensing Requirements and Insurance Line Definitions in Some States also Affect Reciprocity and Uniformity**

Despite progress to move reciprocity and uniformity forward through GLBA, PLMA, and the URLS, a lack of uniform producer licensing standards across states has limited reciprocity and uniformity. Some industry groups suggested that even NAIC-certified reciprocal states have additional or different requirements and processes for applicants. In some states, definitions of insurance lines and the number of insurance lines vary. For example, some states have followed the PLMA to define major lines with variable life and variable annuity as one line, requiring only one license to sell both types of products. Other states treat them separately as individual lines, and may require separate licenses for each. In addition, some states use limited lines definitions beyond the five categories defined in the URLS, which could require agents to obtain additional licenses. For example, some states have a line for luggage protection, which is not one of the URLS categories. The effect is that insurers experience the time,



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cost, and inefficiency that result from following different application processes and standards to meet individual state requirements.

Some states also have additional requirements that may limit reciprocity and uniformity. For example, some states require business entity applicants to register with secretary of state offices before state insurance departments issue producer licenses, but others do not. In addition, some states have different license renewal periods for resident and non-resident insurers. Without more uniform licensing standards, some insurers suggest they will continue to experience greater time and administrative cost burdens that may get passed on to consumers.

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### **A Lack of Full Reciprocity and Uniformity in Producer Licensing Could Lead to Uneven Consumer Protection and Some Inefficiency**

According to some industry participants in our sample, while reciprocity and uniformity of producer licensing across states have grown, the differences in background checks, licensing requirements, and insurance line definitions across states prevent them from achieving full reciprocity and uniformity, and may impact regulators and consumers. For example, differences in state regulators' review of applicants' backgrounds could lead to uneven consumer protection across states, and the resulting lack of reciprocity among states could lead to less regulatory efficiency, as some states do not recognize licenses obtained in other states. Insurers and industry associations have suggested that the different licensing requirements and insurance line definitions in some states could also create inefficiencies as agents operating in multiple states would have to meet different requirements in each state. These inefficiencies could result in higher costs for insurers, which in turn could be passed on to consumers.

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### **Product Approval Has Become More Efficient, but Barriers Exist to Greater Reciprocity and Uniformity**

According to NAIC officials, NAIC and state regulators have taken steps to make product approval more efficient, but barriers to greater reciprocity and uniformity exist in the areas of product review and states' approval processes. NAIC, working with state regulators, has set goals for increasing reciprocity and uniformity in product approval that address inefficiencies in product filing and review and encourage an open and competitive insurance market. NAIC and state regulators have standardized the initial filing process by creating an automated system that states and insurance producers may use for filing submissions, which is the first part of product approval. However, some states still have individual filing review and follow-up practices that work against uniformity. To improve the speed and efficiency of product approval, NAIC and some states have developed an Interstate Compact with

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standardized procedures for approval, but only for certain lines of insurance and only for participating states. Without greater reciprocity and uniformity of insurance product approval, regulatory inefficiencies may raise costs for insurance producers and result in less product choice and higher costs for consumers.

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### NAIC Has Set Goals for Increasing Reciprocity and Uniformity for Product Approval

NAIC has made progress in its efforts to make product approval processes more uniform and reciprocal by creating its 2003 Modernization Plan, which outlined written goals for improving the speed and efficiency of product approval across states. The plan gives insurance regulators a guide for improving reciprocity and uniformity of insurance oversight across states. Specifically, the plan calls for interstate collaboration and reforms to make filing more efficient so that states can improve the timeliness and quality of their reviews of insurance product filings. The plan also sought to integrate multi-state regulatory procedures with individual state regulatory requirements. For example, all states would use regulatory tools, such as uniform filing transmittal documents and a review standards checklist, which would allow insurance companies to verify state requirements before making filings. The plan also called for creating the Interstate Compact, which would develop uniform national product standards and provide a central point of filing. The Compact would use the standards to receive filings, review their contents, and facilitate approvals that would be honored by all participating states.

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### NAIC Has Automated Some Product Approval Processes, but Many States Still Have Individual Requirements

NAIC, in conjunction with state regulators, developed SERFF to simplify, automate, and standardize the way insurers develop and submit insurance product rate and form filings. According to NAIC, SERFF provides a fast, simplified, electronic process for filing and provides filing checklists for those submitting filings. As of March 2009, SERFF was used by 52 states and jurisdictions. Florida does not use SERFF but does require electronic filing for product approval submissions. According to NAIC officials, the frequency of SERFF filing use has also grown, with filings increasing from around 7,000 in 2001 to around 550,000 at the end of 2008. Officials noted that as of March 2009, approximately 85 percent of all product filings to state insurance departments had occurred through the system. Since SERFF implemented a standardized, electronic process and checklists for required filing materials and processes, NAIC and some state regulators and industry associations reported that filing submission errors had decreased significantly and approvals of filings that did not require revisions had increased dramatically.

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While SERFF has resulted in product filing improvements, several limitations to greater reciprocity and uniformity remain. First, while SERFF provided a uniform way for insurers to submit product filings, states' processes for reviewing and following up on filings may involve different procedures and approaches, and some states may require varying levels of additional documentation on products. Second, state regulators and their staffs may have varying levels of resources and expertise and their own informal ways of conducting reviews that create different approaches among states. Some states and one insurer in our sample reported that these differences might work against product approval reciprocity and uniformity. Specifically, the groups suggested that these individual state approaches, or "desk drawer" practices, may be inefficient because they represent fragmented ways of reviewing the same or very similar products. Some industry participants reported that the effect of desk drawer practices increases the time it takes insurers to get their products approved for sale, raising costs for consumers. However, such practices may also allow regulators to target efforts to protect consumers based on state-specific concerns and issues.

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### States Have Created a Compact for Certain Lines of Insurance, but Limited Participation and Other Challenges Limit Its Effectiveness

According to NAIC, many state insurance regulators now participate in the Interstate Compact for multistate insurance product approval. According to NAIC and the Interstate Insurance Product Regulation Commission (IIPRC), NAIC and state regulators created the framework for the Compact in 2000 and developed a working group for the Compact and an Interstate Insurance Compact Model Law in 2002. The Compact was formally created when the first two states, Colorado and Utah, enacted legislation required at the state level to allow each state to join the Compact. NAIC noted that the IIPRC, an organization that manages the operations of the Compact, was established in May 2006, and in December 2006 the IIPRC adopted its first uniform product standards. It operates as a multistate public entity and serves as a single point for filing, review, and approval of life insurance, annuity, disability income, and long-term care insurance products. Once approved by the IIPRC, products may be sold in all member states. The Compact was developed to make processes for filing, reviewing, and approving certain insurance products more efficient and effective, and it aimed to promote uniformity through national product standards and processes. According to NAIC, as of March 2009, Compact membership consisted of 34 states and insurance jurisdictions (fig. 3).<sup>16</sup>

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<sup>16</sup>According to NAIC, the New Mexico legislature approved joining the Interstate Compact on March 20, 2009, and the governor's signature is expected shortly.



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Compact-approved products. In addition, some industry participants noted that states that have not joined the Compact may feel their current product approval and consumer protection processes are superior to the Compact's processes. Some industry participants, however, say that without fuller participation by states, full reciprocity and uniformity, even for the limited number of insurance lines covered by the Compact, will be difficult to achieve. Some states in our sample have formed their own alternative for product approval. Officials from the states of California and Texas noted that several states and jurisdictions, including California, Florida, Texas, and the District of Columbia, formed the Multi-State Review Program, which expedites product approval for annuity products using standards agreed upon by the program's participants. However, a system comprised of compacting states, non-compacting states, and states forming their own approval arrangements has raised some concerns that multiple product approval systems may work against uniformity.

Other issues with the Compact may also limit reciprocity and uniformity. According to some industry participants, some Compact processes allow states to make their own decisions regarding the nature of the products being approved. For example, under the Compact, states can decide whether they will allow fraud exceptions to life insurance policy incontestability clauses, or provisions in life insurance policies that generally limit insurers to a period of 2 years to determine whether policyholders misrepresented their health status and information. These clauses generally protect insurers against misinformation that might be provided by policyholders and consumers against insurers that might deny policyholders coverage despite collecting years of premium payments. According to some industry participants, uniformity will be difficult to achieve if states have the ability to make individualized decisions that do not apply across multiple states.

Further, two consumer groups expressed concern that the commission lacks transparency and accountability. First, these groups pointed out that product filings to the commission are not public, in contrast with some states that require publicly available insurance product filings. With the commission, product information does not become public until or unless products are approved. As a result, consumer groups suggested that they and others do not have an opportunity to review filings and help ensure that harmful products do not get approved for market. However, one state and one insurer offered a number of reasons for not having public filings, including (1) protection of insurers' proprietary information, (2) potential misuse of competitors' information in marketing or lawsuits, and (3) the possibility that consumers will not understand the information or might be

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misled by it. For example, one insurer noted that product filings can be complicated and are written for regulatory review rather than to inform consumers. However, consumer groups suggested that without greater review of proposed products, it would be difficult for advocates to help protect consumers and hard for the general public to be informed buyers of insurance products. Second, consumer groups expressed concerns that the lack of public filings would make it much harder for consumer groups and the public to identify how suitable potential new products might be for consumers before they are approved. These groups noted that the commission's standards provide uniformity for filing submission, review, and approval, but do not address issues of consumer suitability. And third, consumer groups questioned what recourse the commission offered consumers in the event that an insurance product harmed the public. The groups noted that it was unclear whether consumers could sue the commission the same way they might sue a state if an insurance product harmed them.

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### Full Reciprocity Is Unlikely for Approvals in Property/Casualty Insurance Lines

According to some industry participants, while the Compact has increased reciprocity of approvals for some life, annuity, and long-term care insurance products, similar reciprocity is unlikely for property/casualty insurance products. According to some regulatory officials, the products covered by the Compact lend themselves to more uniform approval standards and processes because they are "mobile products," such as life insurance policies, that can move with consumers and are less subject to local geographic characteristics such as weather, earthquakes, or urban versus rural environments. In addition, property/casualty products must conform to a number of relevant state laws, which often differ across states. These include laws regarding responsibility for, and limits to, damages, which differ across states. For example, some states allow joint and several liability in the recovery of damages, while others might not.<sup>17</sup> Some states limit certain types of damages, such as pain and suffering, while others do not. According to one state, to the extent that property/casualty policies must be written to account for each state's

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<sup>17</sup>Joint and several liability is a form of liability used in civil cases where two or more parties are found liable for damages. The winning plaintiff in such a case may collect the entire judgment from any one of the parties regardless of fault or from any and all of the parties in various amounts until the judgment is paid in full. This generally means that if any of the defendants do not have sufficient assets to pay an equal share of the award, the other defendant must make up the difference. Joint and several liability is most relevant in tort claims.

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specific laws, reciprocity across states for approval of these policies will be limited.

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### A Lack of Reciprocity and Uniformity Could Lead to Inefficiencies That Impact Consumers

According to some industry participants, lack of reciprocity and uniformity in product approval processes could lead to inefficiencies that may have negative impacts across the insurance industry. First, when different states conduct product approval in multiple ways, such as through a voluntary compact that some states do not join or by striking individual agreements with other states, regulators may have difficulty achieving an efficient nationwide system of insurance oversight that produces uniform processes and consistently high standards. Uneven levels of protection across states may also mean that consumers may be better protected in some states than others. Second, according to some industry participants, when states have different approaches and practices for product approval, it may be difficult for insurers to achieve product approval in timely, cost-effective ways that enable them to bring new products to market that could serve consumers. Some insurers said that different state processes mean that insurers that file for approval in multiple states will have to produce multiple applications or tailor them to meet state requirements. And third, when regulators and insurers face such challenges, producing an insurance regulatory structure that consistently protects consumers across states becomes difficult to achieve.

Lack of reciprocity and uniformity and the inefficiencies that may result from different product approval systems may impact both insurers and consumers in additional ways. Some insurers in our sample specifically suggested that these inefficiencies cost insurers and regulators time and financial resources and may inhibit the introduction of new products that could serve consumers as they seek protection against various risks. In addition, some industry participants noted that lack of uniformity and reciprocity in product approval processes may lead to higher costs for insurers and, in turn, consumers.

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## NAIC Has Taken Steps Designed to Improve Market Conduct Regulation, but Differences among States Have Limited Progress toward Reciprocity and Uniformity

NAIC and the states have taken steps to improve market conduct regulation, but variations in how states carry out market conduct oversight and in state laws and resources have limited progress toward reciprocity and uniformity. NAIC has established goals aimed at producing common market analysis and examination standards that states can use as the basis for a uniform market conduct program. In addition, NAIC has created guidance to help state regulators better manage and more uniformly approach market conduct oversight. While these efforts have encouraged more standardized practices for market conduct analysis and examination, states vary in how uniformly they use NAIC guidance and tools and in the resources and staff they have available for market conduct regulation. States' varied use of the NAIC's market conduct guidance, varying individual state insurance laws, and different levels of resources and staff expertise may also lead to market conduct inefficiencies and uneven consumer protection across states.

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## NAIC Has Established Goals for Improving Market Conduct Regulation

NAIC has moved market conduct regulation forward by establishing goals and guidance in its 2003 Insurance Regulatory Modernization Action Plan (Modernization Plan), which aimed to improve uniformity of market conduct oversight by state regulators and covered other areas such as producer licensing and product approval. For market conduct oversight, the plan's goals called for formal and rigorous market analysis across states. NAIC promotes analysis in order to help regulators identify market problems and companies and better protect consumers. According to NAIC officials, data collection and analysis were also intended to equip regulators with information that could help them better target their efforts and resources rather than relying on broader, more expensive exams to identify and respond to issues. The plan also calls for each state to adopt uniform market analysis standards and procedures and integrate market analysis into their overall regulatory functions. NAIC goals were developed, in part, in response to a 2003 GAO report, which recommended that NAIC and the states identify a common set of standards for a uniform market conduct program for use by all states, including procedures for market analysis and coordinating market conduct exams.<sup>18</sup> We also recommended that NAIC and states establish a mechanism to encourage state legislatures to adopt and implement the minimum standards. While NAIC and state regulators have taken some steps

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<sup>18</sup>GAO, *Insurance Regulation: Common Standards and Improved Coordination Needed to Strengthen Market Regulation*, [GAO-03-433](#) (Washington, D.C.: Sept. 30, 2003).



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to improve market conduct regulation, variations among state standards still exist.

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### NAIC Has Initiated a Number of Efforts to Improve Market Conduct Regulation, but Implementation among States Has Varied

NAIC has taken several steps to improve market conduct regulation that include updating examination guidance and developing new data collection and analysis tools to promote uniformity. In addition, NAIC created a list of fundamental skills and resources state regulators should have for oversight of the insurance industry. NAIC has also sought to improve coordination of enforcement actions across states. However, use and implementation of these tools and guidance have varied across states.

### NAIC Has Developed Market Conduct Guidance and an Accreditation Program, but States' Use of the Guidance Varies, and the Program Has Not Been Implemented

According to NAIC officials, NAIC has initiated a number of efforts to improve market conduct regulation with tools and guidance for more standardized examination approaches. NAIC developed market conduct examination standards and procedures in its *Market Regulation Handbook (Handbook)*, published in 2006. For example, NAIC officials told us that the *Handbook* updated NAIC's market regulation guidance by combining standards for market analysis and market conduct examinations into one document. Revisions to the *Handbook* and the tools and guidance it contains were designed to help states move from relying on broad examinations for identifying market conduct issues to using market data and analysis to identify problems and target regulatory responses.

In addition, NAIC officials told us that NAIC developed the *Market Conduct Uniform Examination Outline* in 2002 to promote state uniformity in examination scheduling, pre-examination planning, core examination procedures, and examination reporting. The outline sought to help minimize state variations in market conduct examinations. Among other things, the *Outline* includes a list of reasons for examinations, such as:

- complaints,
- extent of an insurer's market share,
- financial examination findings,
- findings from other state regulators,
- a shift in business practices,
- past history of noncompliance,
- information collected through regulatory surveys,
- length of time since the last examination, and
- new laws enacted since the last examination.

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According to NAIC officials, states can use the *Outline* at their discretion and self-certify with NAIC that they are using it, though NAIC does not verify states' reporting. Self-certification allows NAIC to gauge the extent of compliance with the *Outline*.

To promote a set of strong, uniform standards for market oversight, NAIC also developed guidance in the form of 99 core competency standards, which it considers to be fundamental capabilities and resources that state regulators should have in place for strong market conduct oversight. The body of core competency standards consists of four principle elements. First, departments of insurance should have the authority to analyze, examine, or investigate any entity involved with insurance transactions. Further, departments should have the staff training, resources, and types of examiners needed for market conduct oversight. Second, departments should have the ability to conduct market conduct data collection and analysis and designate appropriate staff leaders responsible for an effective market analysis program. Third, departments ought to have a means of moving from market analysis to regulatory action by developing a spectrum of regulatory tools that are available for use in response to market conduct examinations, investigations, and consumer complaints. The fourth principle element of the core competency standards aims to promote interstate collaboration in regulatory action through participation in NAIC working groups and databases and information sharing among regulatory staff designated as contacts on multistate enforcement actions.

According to NAIC officials, in addition to the *Handbook* and *Examination Outline*, NAIC has been working since 2005 to develop an accreditation program for market conduct regulation. NAIC developed the financial accreditation program in 1990 to help ensure uniformity of financial solvency regulation by the states. Its proposed market regulation accreditation program seeks to promote a market conduct accreditation process so that states can objectively monitor and oversee the conduct of insurers and protect consumers. Specifically, the program outlines six market conduct accreditation categories, based on the 99 core competency standards:

- data collection and reporting, including use by states of key NAIC databases such as the Regulatory Information Retrieval System (RIRS), Complaints Database, Market Analysis Review System (MARS), Market Conduct Examination Tracking System, Special Activities Database (SAD), and Market Initiative Tracking System (MITS);

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- market analysis, which includes having appropriate regulatory staff with specific responsibility for data analysis and developing a baseline understanding of insurance markets and issues;
  - market conduct examinations, including having procedural guidelines and standards in place to determine when examinations should be called, and which adhere to the *Scheduling, Coordinating, and Communicating* chapter of the *Market Regulation Handbook*;
  - interstate collaboration, including contacts designated by commissioners of insurance for the purpose of interstate communication and collaborative actions;
  - oversight of contractors hired by insurance departments that have the expertise and professional qualifications to perform market conduct and analysis and examinations; and
  - treatment of confidential information, meaning that insurance departments should have the authority to analyze, examine, or investigate entities involved with the business of insurance, as well as protect consumers, enforce a continuum of regulatory responses when needed, and keep records and insurance information confidential.

According to NAIC, while it encourages states to use its tools and guidance when developing market conduct oversight programs, use of the *Market Regulation Handbook*, including the Examination Outline is not mandatory and states have discretion regarding the extent to which the tools are implemented. Some of the state regulators in our sample noted that they used the *Handbook* to the extent its provisions were consistent with their state laws and market conduct priorities. For example, officials from one state department of insurance told us that they had instructed market conduct staff to use the *Handbook* as a foundation to develop its current revisions to market conduct procedures, but only if the *Handbook's* guidelines did not conflict with the state's statutes or regulatory priorities. According to NAIC officials, as of March 2009, 41 states and the District of Columbia had self-certified compliance with the *Examination Outline*; NAIC does not validate states' certification and has no immediate plans to do so.

While NAIC has fully developed core competency standards and drafted a market regulation accreditation program, use of the standards has been varied, and the accreditation program, as of March 2009, was still a proposal that had not yet been implemented. For example, as of that date, NAIC officials told us that 29 states and jurisdictions reported through an NAIC survey that they met the general core competency standards. In addition, according to NAIC, the accreditation program's core competency

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NAIC Has Developed Data Collection and Analysis Tools, but Faces Challenges in Its Efforts to Collect Market Conduct Data from Insurers

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standards require state insurance regulators to follow the *Scheduling, Coordinating, and Communicating* chapter of the *Market Regulation Handbook* with respect to planning market conduct examinations, but not other key market conduct guidance found in the *Handbook*. For example, the market conduct accreditation program's core competency standards do not require adherence to guidance such as how to conduct property/casualty, life and annuity, health, and multi-state examinations. Without requirements to follow other key parts of the *Handbook* as part of the market conduct accreditation program, it is unclear to what extent the program will help ensure strong market conduct practices and encourage uniform examination procedures across states.

NAIC has created market conduct data collection and analysis tools, but efforts to collect market conduct data from insurers face challenges. To improve data collection, NAIC developed the Market Conduct Annual Statement (MCAS), which began first as a pilot project in 2002 and became permanent in 2004. MCAS is a data collection instrument designed to help state insurance regulators better understand insurers' conduct in the marketplace, identify problem areas, and use information to target market conduct responses and examinations. The information collected includes, for example, annual data on how long it takes insurance companies to settle claims and the separate numbers of complaints insurers received from state departments of insurance and directly from consumers. Additional examples of MCAS data elements collected on different lines of insurance can be found in appendix III.<sup>19</sup> According to NAIC, once the data are collected, state regulators use it to establish baseline measures for targeting their market conduct efforts and prioritizing companies for regulatory attention. State regulators may use deviation from the measures as criteria for following up with an insurer on their conduct or undertaking an examination.

According to NAIC officials, as of March 2009, 29 states were collecting data using MCAS. Other states used their own processes for tracking market conduct and identifying issues that required regulatory attention. For example, several state regulators reported using the information collected through MCAS to perform baseline analysis on insurance companies writing business in their states, identify insurer conduct that

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<sup>19</sup>Appendix III contains a more comprehensive list of the data elements collected in the MCAS for insurance products, including Individual and Group Life, Fixed and Variable Annuities, Private Passenger Auto, and Homeowners products.

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might require their attention or an examination, or monitor individual company and industry trends. One state regulator noted that since it had begun participating in MCAS, its market conduct staff no longer depended exclusively on premium volume or basic complaint activity to monitor an insurance company's market conduct. Further, according to the regulator, MCAS helps the department to identify potential problems and their sources, thereby allowing department staff to target their responses rather than perform a comprehensive review.

According to NAIC, while MCAS provides NAIC and insurance regulators with detailed market conduct data, greater uniformity and participation have been limited by disagreement among insurers and consumer groups over the types of data that MCAS collects and the extent to which the data should be made public. According to several insurers and industry officials, public access to MCAS is problematic because they (1) consider MCAS data to be proprietary and fear their competitive position might be compromised if other insurers had access to it, (2) believe MCAS data could be misunderstood by the general public and used to make poor insurance decisions, and (3) feel MCAS data could be misused by trial attorneys to try to initiate class action suits against insurance companies. However, some consumer groups mentioned that MCAS data would better serve consumers if it contained more detailed insurer information than the summary level data currently collected. In their view, more detailed data would help consumers better compare insurance companies and their products and would help regulators better protect consumers by using data to identify and react to market conduct issues. These disagreements about the data types, uses, and access have slowed consensus and cooperation on the use of uniform data to improve market conduct and have limited progress toward strong, uniform oversight.

While the data access issues had not been resolved as of March 2009, NAIC officials noted that they will begin aggregating market conduct data in 2009 for eventual use by participating states during their oversight activities. NAIC also plans to continually refine data collection, aggregation, and analysis processes, and it plans to work with states and the insurance industry on existing and future MCAS concerns. In addition, some industry participants in our sample noted that it was difficult to achieve greater market conduct uniformity when not all states participate in standardized improvement efforts like the MCAS. NAIC has suggested that without greater state participation in this tool, some regulators will have to rely more on exams, which can be costly and duplicative across states, than on market analysis to monitor the marketplace and protect consumers.

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### NAIC Has Taken Steps to Improve Coordination of Enforcement Actions

In addition to MCAS, NAIC created Level 1 Analysis in 2005, which is an automated set of questions regulators can use to help evaluate individual companies. NAIC then built on Level 1 Analysis by developing Level 2 Analysis that offers regulators additional sources of possible information on insurers' market conduct. Further, NAIC developed MARS in 2005, which stores Level 1 Analysis questions and insurers' answers. The MARS database can be accessed by states and helps regulators identify and respond to market conduct issues by seeing analysis performed by other states. NAIC sees these developments as standardized, uniform tools that state regulators can use to improve access to key regulatory information, identify insurance issues, and respond with targeted actions.

NAIC has also taken steps to improve coordination of enforcement actions across states, but uniformity here is uncertain. NAIC formed the Market Analysis Working Group (MAWG) in 2003 to help states coordinate insurance regulatory actions. Specifically, the group functions to facilitate interstate communication on identified or potential market conduct issues, share information of common concern regarding insurers' activity, and promote a targeted regulatory response from a spectrum of possible actions. Some states in our sample said that through MAWG, several multistate collaborative actions had been initiated in both market conduct examinations and settlements. In addition, one state insurance department noted that MAWG's quarterly meetings and the open lines of communication among states enabled it and other states to bring problem companies to the attention of the group for possible coordinated regulatory action. According to NAIC officials, because state regulators have a forum to discuss regulatory issues and actions, MAWG has also facilitated a more consistent range of regulatory responses to similar multistate concerns.

In addition to MAWG, NAIC developed MITS in 2006, which enables states to track and share regulatory actions by entering these actions into an electronic database. For example, several states told us that they log their market conduct activities into MITS so that other states can learn about their issues and actions. Further, NAIC developed RIRS, a database that dates back to the 1980s but was automated in 1995, specifically allows states to see the adjudicated regulatory actions of other states. NAIC officials noted that the RIRS system helps them monitor the insurance market, hone in on issues they consider significant, and more efficiently respond to those issues.

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## Variation in State Laws and Resources Have Limited Progress toward Uniformity

Individual laws passed by state legislatures and implemented by state insurance departments govern market conduct regulation and consumer protection activities. While such differences allow for the regulatory flexibility needed in a diverse national marketplace for insurance, different laws, regulations, and practices may make greater uniformity among states difficult to achieve. To help increase the uniformity of state laws regarding market conduct activities, in 2004 NAIC and NCOIL worked to jointly develop a market conduct model law that created market conduct standards to promote uniformity across states. However, according to NAIC, differences among states played a significant role in limiting support for the model law, and ultimately only one state adopted it.

Market analysis and examination uniformity are also limited by variations among states regarding their respective resources. According to NAIC, states that have greater budgetary and staff resources may be able to undertake more detailed data collection and analysis and respond using NAIC's market conduct tools and guidance to a greater degree than states that have fewer resources. In addition to budgetary and resource differences, states may also vary in the levels of expertise their staff possess for conducting the data collection and analysis state regulators may use to identify and respond to market conduct issues. States with fewer resources and less expertise may be less able to analyze and use market conduct information as part of their regulatory oversight. However, some states in our sample noted that state regulators may contract with outside experts to fulfill functions or areas of expertise they lack in-house, and although it may be costly, insurers generally bear these expenses.

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## Limited Reciprocity and Uniformity Can Create Inefficiencies and Uneven Consumer Protection across States

Limited uniformity in the use of NAIC's market conduct tools and in state laws and resources—and the resulting limits on reciprocity among states—may create inefficiencies for insurers and regulators and lead to uneven levels of consumer protection across states. For example, in the absence of uniform examination procedures and criteria for selecting insurance companies to examine, states implement their respective market conduct processes based on state laws, insurance department priorities, and established practices. Varying examination processes across states may mean that insurers may be subjected to multiple and sometimes simultaneous exams by regulators in the states where they operate. An insurer's compliance with examinations by different state regulators may lead to increased costs to the company, which in turn may be passed on to the consumer in the form of higher insurance rates. When

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state regulators do not rely on other states' market conduct oversight, they may have to conduct more regulatory activities on their own.

In addition, state regulators' varying use of the NAIC's market conduct data collection instruments, examination tools, and guidance may lead to varying regulatory efforts in overseeing insurance companies in respective states. According to some insurers and consumer groups, insurance companies located in states that have stronger market conduct surveillance standards may be subjected to more scrutiny than those in states with less stringent market conduct standards. Varying levels of market conduct oversight may lead to uneven levels of consumer protection so that consumers may have stronger protections in some states than others.

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## Conclusions

Reciprocity and uniformity in the insurance areas of producer licensing, product approval, and market conduct regulation can result in benefits to regulators, insurers, and consumers. For regulators, reciprocity and uniformity can mean standardized processes and standards that can lead to efficient and effective ways of working with insurers to license agents and brokers, review and approve products for sale in the marketplace, and protect consumers from harmful actors and products. Reciprocity for insurers means faster, more efficient ways of introducing and gaining approval for new insurance products and assurance that regulatory processes will be similar across states, potentially helping insurers keep their overall insurance product costs lower. An insurance system with greater reciprocity and uniformity may also limit inefficiencies that could contribute to higher product costs for insurers and consumers and may provide for more coordinated, even consumer protection across states. To the extent that reciprocity and uniformity are limited across states, benefits to regulators, insurers, and consumers may also be limited.

NAIC has made progress on reciprocity and uniformity in key areas of producer licensing, product approval, and market conduct, but this progress has not come quickly and in some cases has been limited.

- Efforts to achieve greater reciprocity in producer licensing began following passage of GLBA in 1999, and as of March 2009, 47 states had been certified as reciprocal. However, several key states, including California, Florida, and New York, were still not considered reciprocal for non-resident producer license applicants, and it appears that many states still impose separate or additional requirements on resident producers. In addition, as of March 2009, only 17 states were conducting criminal



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background checks on applicants, resulting in uneven consumer protections across states. Finally, we recommended in 2000 that NAIC and state insurance regulators develop mechanisms for routinely obtaining regulatory data from financial services regulators. Limited progress has been made in this area, and we continue to believe that the development of such a system is an important element of effective consumer protection efforts.

- NAIC furthered efforts to improve reciprocity and uniformity in the approval of insurance products when it implemented SERFF in 1998, a system that has automated the process of applying for the approval of insurance products. As of March 2009, SERFF was used in 52 states and jurisdictions, and approximately 85 percent of all filings were achieved through the system. NAIC and the states also advanced product approval reciprocity and uniformity with the creation of its Modernization Plan in 2003. In addition, NAIC and the states created the Interstate Insurance Product Regulation Commission, a single product approval entity that approves products that are recognized among the compacting states. Nonetheless, it appears that many states are still imposing their own approval practices and requirements on insurers, which limit both reciprocity and uniformity. In addition, the compact is limited to 34 states and jurisdictions and only certain types of insurance products.
- NAIC and the states have also made efforts to improve market conduct regulation, which were items noted in NAIC's 2003 Modernization Plan and addressed in a 2003 GAO report. Our report recommended that NAIC and states take steps to adopt and implement minimum standards for market conduct oversight that would include all states.<sup>20</sup> We still believe improvements are needed to address remaining market conduct regulatory differences among states. Such actions could include ensuring that all appropriate guidance—for example, from the *Market Regulation Handbook*—be included as part of the accreditation process, and ensuring that states meet uniform minimum standards in a timely manner. NAIC and state insurance regulators have completed some improvements, such as revising market conduct guidance and creating a market conduct working group that has helped increase uniformity across states. However, other important efforts, such as the collection and use of standardized market conduct data and implementation of the core market conduct competency standards, were still incomplete as of March 2009. As a result, uniformity across states may be limited, and consumer protections may vary.

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<sup>20</sup>GAO, *Insurance Regulation: Common Standards and Improved Coordination Needed to Strengthen Market Regulation*, GAO-03-433 (Washington, D.C.: Sept. 30, 2003).

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Regulators have faced, and will continue to face, a number of challenges to increasing reciprocity and uniformity in these areas. For example, insurance regulatory improvement may require increasing uniformity of state laws that govern licensing requirements and product approval, which in turn requires cooperation from state legislatures. NAIC and state insurance regulators' work with state legislatures has occurred over a number of years, and some regulators told us that cooperation had been difficult to achieve in some areas. In particular, according to NAIC, despite efforts in many more states, regulators in only 17 states have obtained statutory authority to conduct full criminal background checks with fingerprinting. Another challenge is the differing levels of resources and expertise among state insurance departments, which means that some states may have the resources and staff for certain efforts, while others may not. Further, NAIC's operations generally require consensus among a large number of regulators, and NAIC seeks to obtain and consider the input of industry participants and consumer advocates. Obtaining a wide range of views may create a more thoughtful, balanced regulatory approach, but working through the different goals and priorities of all of these entities can result in lengthy processes and long implementation periods for regulatory improvements. Continued progress in a timely manner, however, is critical to improving the efficiency and effectiveness of the insurance regulatory system.

We also recognize that the costs and benefits of further increases in reciprocity and uniformity must be considered. Regulators, insurers, and consumers may not benefit if achieving uniformity occurred by simply lowering standards across states. At the same time, it may not be feasible to achieve reciprocity and uniformity across states by meeting the highest standard achieved by any one state. In addition, it is not clear that full reciprocity in some areas would be realistically achievable. For example, as we have said, uniformity and reciprocity for the approval of property/casualty products would require significant changes in state laws, including a wide body of tort law. States have tailored those laws to best protect their residents, and since many are not exclusive to insurance, such large-scale changes may be unlikely.

As the insurance regulatory system is part of the broader financial regulatory system, it should support the goals that the federal government has for the entire financial regulatory system and should be part of discussions for potential regulatory reforms. In a recent report, we suggested a number of goals for the U.S. financial regulatory system. Reciprocity and uniformity within the regulation of insurance could support at least four of these goals. First, a regulatory system where

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changes can be made uniformly across states may be able to more readily adapt to innovations and changes in the insurance market. Second, greater reciprocity and uniformity could lead to a more efficient system for regulators through the reduction of overlapping activities, as well as for insurers by reducing the number of different requirements they must meet across states. Third, greater uniformity across states could provide more consistent protection for consumers purchasing similar products and services. Fourth, greater uniformity could also provide more consistent financial oversight for similar institutions, products, and services. In that report we also noted that, given the difficulties to harmonize insurance regulation across states, Congress could explore the advantages and disadvantages of providing a federal charter option for insurance and creating a federal insurance regulatory entity. The establishment of a federal insurance charter could help alleviate some of these challenges, but such an approach could also have unintended consequences for state regulatory bodies and for insurance firms as well. However, any consideration of a change to the current insurance regulatory structure, including a possible federal insurance charter, should involve appropriate cost-benefit analysis.

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## Matter for Congressional Consideration

In order to improve how state insurance regulators identify insurance license applicants with criminal backgrounds and protect consumers, Congress, as it explores the advantages and disadvantages of a change to the federal role in the regulation of insurance, should explore ways to ensure that all state insurance regulators can conduct nationwide criminal background checks as part of their producer licensing and consumer protection functions.

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## Recommendation to NAIC and State Insurance Regulators

To continue progress achieved through NAIC's electronic and automated product filing processes, we also recommend that NAIC and state regulators work with the insurance industry to further identify differences in the ways state regulators review and approve filings received through SERFF, and take any necessary steps, where appropriate, to improve consistency in their product approval processes.

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## NAIC Comments and Our Evaluation

We provided a draft of this report to NAIC. The Chief Operating Officer and Chief Legal Officer of NAIC provided written comments, which are reprinted in appendix II. In commenting on a draft of this report, NAIC's Chief Operating Officer and Chief Legal Officer agreed with our

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recommendation. NAIC also made some general comments about the benefits of state-based regulation.

In the area of producer licensing, NAIC noted that while we acknowledged that 47 states had been certified as reciprocal, we also described reciprocity as limited. As we discuss in the report, while NAIC has made progress in some areas, we continue to view overall progress on uniformity and reciprocity as limited. NAIC and the states have made progress with reciprocity, but the certification process does not include a review of whether states are also complying with the URLs, which added some standards that were not included in PLMA but which NAIC believed were important for meaningful uniformity and reciprocity as noted in the report. For example, the certification process does not require criminal background checks. Also related to this issue, NAIC noted that one procedural issue has been a significant impediment, FBI administrative standards related to fingerprinting. We have added this new information to the report. NAIC also noted a number of other efforts that they have taken in the area of producer licensing including the State Producer Licensing Database.

In the product approval area, NAIC commented on a variety of issues and provided some updated data on the Interstate Compact and activities of Interstate Insurance Product Regulation Commission (IIPRC), both of which are discussed in the report. Moreover, they noted that they have continued to make progress in adopting uniform standards in certain property lines and that more companies are registering. The letter also provides NAIC's views on the flexibility and improvements afforded states regarding product approval, an issue raised during the course of our work and discussed in the report. NAIC also discusses the Compact approval process and transparency. As we noted in the report, consumer groups we spoke with expressed concern that the product approval process was not more transparent. NAIC commented about suitability and consumer protection issues associated with the Compact by noting that state insurance regulators retain the authority to protect consumers and the Compact preserves consumers' rights to pursue legal remedies not specifically directed to the content of the product.

Finally, with respect to market conduct regulation, NAIC highlighted its efforts in this area and noted that it continues to pursue standardized data collection practices, the development of a Market Regulation Accreditation Program, and participation by all states in MCAS data collection by 2010.

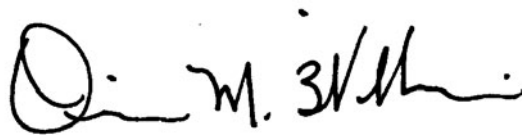
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In addition, NAIC provided technical comments on the report, which we incorporated, as appropriate.

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As agreed with your offices, unless you publicly release its contents earlier, we plan no further distribution of this report until 30 days from its date of issue. At that time we will send copies of this report to interested congressional committees, the Chief Executive Officer of the National Association of Insurance Commissioners, and others. In addition, the report will be available at no charge on GAO's Web site at <http://www.gao.gov>.

If you or your staff have any questions regarding this report, please contact me at (202) 512-8678 or [williamso@gao.gov](mailto:williamso@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix IV.

A handwritten signature in black ink, appearing to read "Orice M. Williams". The signature is stylized and cursive.

Orice M. Williams  
Director, Financial Markets and  
Community Investment

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# Appendix I: Objectives, Scope, and Methodology

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As Congress has considered options to help ensure efficient and effective regulation of the insurance market, policymakers have had a number of questions about the success of recent efforts and the challenges that remain. To address these questions, in each of the regulatory areas of producer licensing, product approval, and market conduct regulation, we have been asked to assess (1) the progress NAIC and state regulators have made to increase reciprocity and uniformity, (2) the factors that have challenged efforts to achieve greater reciprocity and uniformity, and (3) the potential effects on the insurance industry and consumers if greater progress is not made.

To assess the progress, challenges, and potential effects on the insurance industry and consumers related to reciprocity and uniformity in producer licensing, product approval, and market conduct, we interviewed officials from state insurance departments, the National Association of Insurance Commissioners (NAIC), the National Conference of Insurance Legislators (NCOIL), primary insurance companies, insurance associations, and consumer advocacy groups. We met with insurance regulators from nine states—Alabama, California, Florida, Georgia, Illinois, New York, Texas, Pennsylvania, and Ohio. We selected this sample of states due to the states' geographic diversity and respective premium volumes, which ranged from small to large. The four insurers we met with provided property and casualty insurance coverage and life and health insurance to consumers. We also met with several industry associations representing insurance companies covering property and casualty and life and health insurance lines across states. The consumer advocacy groups with whom we met represented both individual state consumers and consumers nationwide. We also reviewed congressional testimony from knowledgeable industry participants, several of whom we interviewed for this study. Further, we examined regulatory documents such as NAIC's Insurance Regulatory Modernization Action Plan (Modernization Plan) and NAIC's standards and guidelines concerning producer licensing, product approval, and market conduct regulation. Finally, we reviewed our previous reports and testimonies and Congressional Research Service reviews.

To examine the progress, challenges, and potential effects on the insurance industry and consumers related to producer licensing reciprocity and uniformity, we spoke with NAIC officials, NCOIL officials, state insurance regulators, insurance companies, insurance associations, and consumer advocacy groups. To obtain information on the producer licensing goals that NAIC established, we reviewed NAIC's 2003 Modernization Plan and other NAIC documents. We also reviewed our

previous reports and testimonies that called for improvements to producer licensing. To document the states that NAIC has certified as reciprocal for producer licensing, and those states that have statutory authority to perform criminal background checks with fingerprinting, we relied on NAIC data.

To examine progress in making product approval more efficient, the barriers to further reciprocity and uniformity and the potential effects if more progress is not made, we spoke with NAIC, NCOIL, states, industry representatives, and consumer advocacy groups. We reviewed NAIC's Modernization Plan and other NAIC documentation to determine NAIC's product approval goals. Previous GAO studies provided recommendations geared toward improvement of product approval regulation. To gather information on the states that have joined the Interstate Compact, we relied on NAIC and Interstate Insurance Product Regulation Commission (IIPRC) data.

To examine the steps NAIC has taken to improve market conduct reciprocity and uniformity, and the potential impact on the insurance industry if greater progress does not occur, we spoke with NAIC, state insurance regulators, insurance companies, insurance industry associations, and consumer advocates. Documentation from NAIC such as the Modernization Plan and the *Market Regulation Handbook* provided us with NAIC's market conduct goals and guidance to promote uniform market conduct standards. To obtain information on the specific data elements collected through the MCAS, we relied on NAIC documentation on elements collected for individual and group life, fixed and variable annuities, private passenger auto, and homeowners insurance products.

We conducted our work from February 2008 through April 2009 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

# Appendix II: Comments from the National Association of Insurance Commissioners



National Association of Insurance Commissioners

March 31, 2009

Ms. Orice M. Williams  
Director, Financial Markets and Community Investment  
U.S. Government Accountability Office  
441 G. Street, NW  
Washington, DC 20548

Dear Ms. Williams,

Thank you for the opportunity to submit comments on the GAO's Report, *Insurance Reciprocity and Uniformity*. We appreciate the GAO's continued interest in state-based insurance regulation and its recognition of the progress the NAIC and its members, the nation's chief insurance regulators, have made in modernization. We agree with the GAO's recommendation for the NAIC and state regulators to continue working to improve consistency where appropriate in the review and approval of product filings. We also look forward to working with Congress as it considers the GAO recommendation concerning nationwide criminal background checks for insurance producers.

As a general comment, I note the three areas on which this report focuses (Producer Licensing, Product Approval and Market Conduct Regulation) are important focus points for state insurance regulators. However, we would not want readers to view these areas as the primary focus of state insurance regulation, to the exclusion of the financial solvency arena. Also, the report places a great deal of emphasis on uniformity in the identified areas. Although the NAIC and its members have made great strides towards uniformity as the report describes, we do not view uniformity as a goal in itself. In fact, and as discussed further below, uniformity may not be the right result for insurance consumers or the insurance industry.

Some regulatory practices may vary from state to state depending on consumer protection interests. Furthermore, geographical differences have a significant impact on property and/or casualty insurance and the regulation thereof. Civil justice systems, workers compensation systems, and perils insured against can be state-specific. We note the need for the regulatory system to account for these necessarily state-specific factors exists whether the system is state or federally based.

State-specific factors cannot be ignored in the effort to modernize insurance regulation. The notion anything less than complete uniformity results in "inefficiency" presumes a theoretically flawless alternative. In actuality, a system mandating the same standards for hurricane zones as it does for regions with no such risk would do more to hamper efficiency. Our current system clearly does not inhibit the market, as new products such as pet insurance and identity theft protection continue to emerge. Simply put, not every insurance product lends itself to uniformity, and uniformity does not necessarily lead to a more effective or efficient regulatory system.

Furthermore, states may have different methods of consumer protection, but this does not make consumer protection "uneven" in the U.S. Consumer protections are often state-based and differ from jurisdiction to jurisdiction in such areas as tort law, contract law, and state unfair trade practices acts.

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State criminal laws similarly result in different consumer protections among the states and unequal application based upon prosecutorial or judicial discretion.

In reference to the GAO's general discussion:

- In the brief discussion of a federal insurance charter at the end of the report, there is no recognition the federal government lacks the requisite experience and financial resources necessary to support federal regulation of insurance. The states and the NAIC have the regulatory infrastructure in place to support state-based regulation. A more thorough cost/benefit analysis is necessary to shed any light on the practical consequences of a transition to a federal regulator.
- The report refers to AIG as "one of our nation's largest insurers" and attributes some concern about oversight of the insurance industry to AIG's financial difficulties. In fact, AIG is a global financial services conglomerate that does business in 130 countries. AIG owns 176 other companies, in addition to 71 U.S. state-regulated insurance subsidiaries. AIG's insurance companies remain solvent, in part because state regulation continues to wall them off from the high-risk credit default swap activities engaged in by AIG Financial Products. AIG's Financial Products operation — not its 71 U.S. insurance subsidiaries — created a systemic risk causing the federal government to intercede.

In the area of Producer Licensing:

- The report discusses the process by which states become reciprocal for producer licensing under the Gramm-Leach-Bliley Act. Although the GAO acknowledges 47 states have been certified as reciprocal, and that all states use the *Uniform Application for Individual Insurance Producer License*, reciprocity is nevertheless characterized as "limited". The NAIC's certification of such a vast majority of states demonstrates our commitment to uniform standards and the states' hard work in implementation.
- We agree most states do not conduct background checks including fingerprinting, but the major hurdle in this area is procedural. The draft does not recognize that FBI administrative standards related to fingerprinting remain a significant impediment to access by all states. The report includes a recommendation Congress consider proposals to allow for nationwide criminal background checks, and the NAIC looks forward to working with Congress and other interested parties is carrying out this recommendation.
- The NAIC's efforts in the area of producer licensing do not stop with certification of reciprocity under Gramm Leach Bliley. The State Producer Licensing Database (SPLD) is a central repository of producer licensing information updated on a timely basis by participating state insurance departments. The SPLD includes data from external databases such as the Regulatory Information Retrieval System (RIRS) and the Special Activities Database to provide a more comprehensive producer profile. SPLD contains the following: general demographic information; license information (such as states licensed, license numbers, authorized lines and license status); appointment information (such as company appointments, effective date, termination date and termination reason); and regulatory actions (if taken). Currently, the SPLD includes information from all 50 states, as well as the District of Columbia and Puerto Rico.
- The report refers to state corporate registration requirements as a possible barrier to reciprocity and uniformity in the area of business entity producer licensing. We would note Secretary of State registration requirements are found in state corporate law, not insurance law, and such

requirements apply to all foreign corporations seeking to do business in a state, with limited exceptions. State-based licensing of professionals is the norm and is not considered burdensome for attorneys, to give one example.

In the area of Product Approval:

- Mississippi enacted the Interstate Compact in March 2009 and will become an official member effective July 1, 2009 bringing the total number of compacting states to 34. The Interstate Compact passed the New Mexico legislature on March 20, 2009 and the governor's signature is expected shortly.
- The Interstate Insurance Product Regulation Commission (IIPRC) has now adopted more than 50 uniform standards in the individual life and annuity product lines, providing greater flexibility to companies in their product filing options. In addition, the number of companies registered so far in 2009 has already exceeded the total registrations in 2008, as more companies realize the tremendous competitive and cost-saving benefits of being able to prepare one filing, submit it to one place and receive approval in 60 days or less in up to 33 jurisdictions, 34 on July 1. Currently, the IIPRC turnaround time for product approval is less than thirty (30) days.
- The report notes some Compact processes allow states to make their own decisions regarding product approval. There are only very limited circumstances where the IIPRC uniform standards defer to state law. Under these circumstances, the content of the product filing stays consistent so filers are not required to file multiple versions of the product. Rather, the product is simply required to provide the applicable provision is subject to state law. For the individual life insurance Uniform Standards, there are approximately eight (8) instances where a specific provision of a policy is based on applicable state law. The nature of these provisions is premised on very basic public policy choices of states. The Interstate Compact is not intended to supplant the decisions of state lawmakers on key public policy decisions affecting consumers' personal freedoms and rights. For this reason, the IIPRC standards have provided flexibility to accommodate deference to state public policy in very limited circumstances.
- The GAO refers to consumer group concerns about transparency and accountability for the Compact. It is important to recognize the IIPRC uses a public process to develop uniform product standards for product filings. This process is conducted through open conference calls and public hearings. All comments and documents associated with a product standard are available on the IIPRC website along with a chronological summary of all activity. Standards are reviewed by the IIPRC Management Committee as well as the full Commission before adoption. All parties have the opportunity to participate in the product standard development process. Furthermore, the IIPRC has a comprehensive procedure for public inspection and copying of its information and official records. Product filings, upon IIPRC approval, are public records subject to disclosure. Under the rule, pending, withdrawn and disapproved product filings are generally the only type of product filings not considered public records.
- Suitability of sales to consumers is a very important market regulatory function and for many reasons it is not within the scope of authority of the IIPRC. The Interstate Compact grants limited jurisdiction to the IIPRC over the content, approval and certification of life, annuity, long-term care, and disability income products; and approval for long-term care and disability income rates and advertisements. Suitability of the sale of a Compact-approved product to a certain consumer or

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**Appendix II: Comments from the National  
Association of Insurance Commissioners**

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groups of consumers falls squarely under the purview of the state insurance regulator to carry out his or her authority to oversee the market regulation of the activities of the insurer. The Interstate Compact is not intended to regulate the market activities of the insurers. Rather, the Uniform Standards and the central filing platform is intended to allow companies to prepare one product filing and submit to one place for approval to offer in the compacting states. The states retain their authority to protect their consumers from unsuitable sales of Compact-approved products.

- Finally, the report raises the question of what recourse the Compact offers consumers in the event an insurance product harms the public. Generally, consumers do not take action against states for their approval or disapproval of insurance products. Many states have statutory immunity for their legislative and regulatory actions. The Interstate Compact provides a comparable qualified immunity to the IIPRC members and employees for actions within the scope of Commission activities including product review and approval. Consumers often bring actions against companies for claims related to their activities in the sale or administration of an insurance product. The Interstate Compact clearly preserves consumer access to state courts and remedies available under state law related to breach of contract, tort or other laws not specifically directed to the content of the product.

In the area of Market Conduct Regulation:

- The NAIC provides various market conduct tools and maintains information sharing agreements which allow for and facilitate cooperation and collaboration in market conduct analysis. Furthermore, the Market Actions Working Group (formerly the Market Analysis Working Group) identifies regulatory issues that may impact multiple jurisdictions and supports Collaborative Actions.
- The report acknowledges, and we would like to emphasize, the NAIC continues to work toward standardized data collection practices and the development of a Market Regulation Accreditation Program. Furthermore, the Market Conduct Annual Statement (MCAS) is a data collection tool that is currently utilized in 29 jurisdictions. All jurisdictions have agreed to participate in MCAS data collection by the end of 2010.

Once again, we thank you for the opportunity to review this report and submit our comments. We appreciate your attention to these important aspects of state-based insurance regulation and your recognition of the steps NAIC members have taken to improve the quality of regulation and to move toward uniformity where appropriate. As always, we welcome the GAO's recommendations for further improvement, which will be given careful consideration as we continue our work toward consumer protection and a healthy marketplace for the business of insurance.

Sincerely,



Andrew J. Beal  
Chief Operating Officer and  
Chief Legal Officer

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# Appendix III: Examples of Market Conduct Annual Statement Data Elements

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**Private Passenger Auto Insurance Data Elements**

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Number Of Claims Open At The Beginning Of The Period

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Number Of Claims Opened During The Period

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Number Of Claims Closed During The Period, With Payment

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Number Of Claims Closed During The Period, Without Payment

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Median Days To Final Payment

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Number Of Claims Settled Within 0-30 Days

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Number Of Claims Settled Within 31-60 Days

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Number Of Claims Settled Within 61-90 Days

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Number Of Claims Settled Within 91-180 Days

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Number Of Claims Settled Within 181-365 Days

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Number Of Claims Settled Beyond 365 Days

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Median Days To Date Of Report

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Number Of Suits Open At Beginning Of The Period

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Number Of Autos Which Have Policies In-Force At The End Of The Period

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Number Of Policies In-Force At The End Of The Period

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Number Of New Business Policies Written During The Period

---

Dollar Amount Of Direct Premium Written During The Period

---

Number Of Non-Renewals During The Period

---

Number Of Cancellations That Occur 60 Days Or More After Effective Date, Excluding Those For Either Non-Pay Or At The Insured's Request

---

Number Of Cancellations That Occur In The First 59 Days After Effective Date, Excluding Those For Either Non-Pay Or At The Insured's Request

---

**Homeowners Insurance Data Elements**

---

Number Of Claims Open At The Beginning Of The Period

---

Number Of Claims Opened During The Period

---

Number Of Claims Closed During The Period, With Payment

---

Number Of Claims Closed During The Period, Without Payment

---

Median Days To Final Payment

---

Number Of Claims Settled Within 0-30 Days

---

Number Of Claims Settled Within 31-60 Days

---

Number Of Claims Settled Within 61-90 Days

---

Number Of Claims Settled Within 91-180 Days

---

Number Of Claims Settled Within 181-365 Days

---

Number Of Claims Settled Beyond 365 Days

---

Median Days To Date Of Report

---

Number Of Suits Open At Beginning Of The Period

---

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**Appendix III: Examples of Market Conduct  
Annual Statement Data Elements**

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**Private Passenger Auto Insurance Data Elements**

Number Of Suits Closed During The Period

Number Of Suits Open At End Of Period

Number Of Dwellings Which Have Policies In-Force At The End Of The Period

Number Of Policies In-Force At The End Of The Period

Number Of New Business Policies Written During The Period

Dollar Amount Of Direct Premium Written During The Period

Number Of Non-Renewals During The Period

Number Of Cancellations That Occur 60 Days Or More After Effective Date, Excluding Those For Either Non-Pay Or At The Insured's Request

Number Of Cancellations That Occur In The First 59 Days After Effective Date, Excluding Those For Either Non-Pay Or At The Insured's Request

**Fixed and Variable Annuities Data Elements**

Number Of New Replacement Contracts Applied For During The Period

Number Of New Replacement Contracts Issued During The Period

Internal Replacement Indicator (Yes/No)

Loan Purchase Indicator (Yes/No)

1035 Rollover Indicator (Yes/No)

Replacement Register Indicator (Yes/No)

Number Of Contracts Surrendered During The Period

Number Of New 1035 Exchanges Coming Into The Company During The Period

Number Of New Contracts Issued During The Period

Number Of Contracts In Force At The End Of The Period

Dollar Amount Of Annuity Considerations During The Period

Number Of Complaints Received Directly From Consumers

Number Of Complaints Received Directly From The Corresponding Department Of Insurance

Complaint Register Indicator (Yes/No)

**Individual and Group Life Product Data Elements**

Number Of New Replacement Policies Applied For During The Period

Number Of New Replacement Policies Issued During The Period

Internal Replacement Indicator (Yes/No)

Surrender Indicator (Yes/No)

Loan Purchase Indicator (Yes/No)

1035 Rollover Indicator (Yes/No)

Replacement Register Indicator (Yes/No)

Number Of In Force Policies Containing Policy Loans With An Outstanding Balance Over 25 Percent Of The Maximum Loan Value As Of December 31, 20XX

Partial Surrenders Indicator (Yes/No)

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**Appendix III: Examples of Market Conduct  
Annual Statement Data Elements**

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**Private Passenger Auto Insurance Data Elements**

Number Of New 1035 Exchanges Coming Into The Company During The Period

Number Of New Policies Issued During The Period

Number Of Policies In Force At The End Of The Period

Dollar Amount Of Direct Premium During The Period

Dollar Amount Of Insurance Issued During The Period (Face Amount)

Dollar Amount Of Insurance In Force At The End Of The Period (Face Amount)

Number Of Complaints Received Directly From Consumers

Number Of Complaints Received Directly From The Corresponding Department Of Insurance

Complaint Register Indicator (Yes/No)

Number Of Death Claims Closed With Payment, During The Period, Within 60 Days From The Date Of Due Proof Of Loss

Number Of Death Claims Closed With Payment, During The Period, Beyond 60 Days From The Date Of Due Proof Of Loss

Number Of Death Claims Denied, Resisted Or Compromised During The Period

Total Number Of Death Claims Received During The Period

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Source: NAIC.

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# Appendix IV: GAO Contact and Staff Acknowledgments

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## GAO Contact

Orice M. Williams (202) 512-8678 or [williamsso@gao.gov](mailto:williamsso@gao.gov)

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## Staff Acknowledgments

In addition to the contact named above, Patrick Ward (Assistant Director), Farah Angersola, Emily Chalmers, Barry Kirby, Marc Molino, Steve Ruszczyk, and Jennifer Schwartz made key contributions to this report.

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*State Insurance Regulation: Efforts to Streamline Key Licensing and Approval Processes Face Challenges.* [GAO-02-842T](#). Washington, D.C.: June 18, 2002.

*Regulatory Initiatives of the National Association of Insurance Commissioners.* [GAO-01-885R](#). Washington, D.C.: July 6, 2001.

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*Insurance Regulation: Scandal Highlights Need for Strengthened Regulatory Oversight.* [GGD-00-198](#). Washington, D.C.: September 19, 2000.

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