CPCU SOCIETY
INSURING YOUR SUCCESS

Regulatory & Legislative Interest Group

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Compliance Matters

Message from the Chair

by Joseph F. Bieniek, CPCU, AIE, CCP, CIC, ARC, MCM, AIS, AU, AINS

Joseph F. Bieniek, CPCU, AIE, CCP, CIC, ARC, MCM, AIS, AU, AINS, is the senior regulatory services advisor for the National Association of Insurance Commissioners (NAIC). Before joining the NAIC in 2006, he spent nine years at Wolters Kluwer Financial Services and more than 20 years of his insurance career with Allstate Insurance Company. Bieniek has handled all lines of insurance in a variety of capacities. In addition to serving as chair of the CPCU Society Regulatory & Legislative Interest Group, he is a board member of the Insurance Regulatory Examiners Society (IRES).

It's summer time, and things have been heating up for a while already. Some parts of the United States have been experiencing excessive heat. As I write this, the fires in Arizona and New Mexico continue. There is water in many places from flooding, and in other places, it is so dry we can't get the water needed to take care of the fires. There has been an increased number of tornadoes and deadly tornadoes this year. The hurricane season has begun, and various predictions indicate that the U.S. will have some hurricanes hit landfall. Let's hope **none** hits landfall.

Just like the active weather we've already experienced, the CPCU Society also has been active — only in a good way. I was able to attend the CPCU Society Leadership Summit held in Miami back in April. This was a worthwhile conference to attend, with various workshops devoted to chapters and the CPCU Society Center for Leadership courses. In addition, interest group leaders attended special sessions designed for their unique needs, various Society committees conducted business and the Board of Directors met.

This was the third Leadership Summit I've attended, and I have found all of them valuable for our interest group and for me personally. The Regulatory & Legislative Interest Group Committee met for four hours in Miami, and we did a **great** job preparing for the seminar we are presenting in Las Vegas at the CPCU Society Annual Meeting and Seminars — more on that appears below. I hope you will be able to attend the 2012 Leadership Summit, which is scheduled for April 26–28 in Miami.

I also hope you can attend the CPCU Society Annual Meeting and Seminars in Las Vegas. The Regulatory & Legislative Interest Group Committee is developing "'GAME ON!' — Show Me the Money … Test Your Insurance Knowledge." This session will be held Sunday, Oct. 23, from 2:45–4:25 p.m., and it is filed for CE credits. For complete details on the Las Vegas CPCU Society Annual Meeting and Seminars, go to the Society's website, www.cpcusociety.org, and click the Annual Meeting registration button.

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What's in This Issue?

Message from the Chair

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Insurance, insurance regulation and insurance legislation can be boring. So, the Regulatory & Legislative Interest Group Committee tries to liven things up and have fun while we work through the maze of proposed and active legislation and regulation that impacts the business of insurance. At the 2010 CPCU Society Annual Meeting and Seminars last year in Orlando, we presented Back to the Future — The Journey of Insurance Regulation.

This was an informative and enjoyable session for everyone, and we have no doubt that we will be able to present a session this year that is equally informative and enjoyable. This year, the audience will be participants in our session. We will have teams consisting of seminar attendees who will compete against one another. Questions for the audience will include such topics as the history of insurance, complaints, Federal Insurance Office, and the ins and outs of the CPCU Society. Besides awarding continuing education credit, we will be awarding valuable prizes. Each table will be provided with "CPCU Bucks," allowing team members to bet an amount that matches their confidence in knowing the answer.

Featured in this newsletter is an article on the current status of surplus lines reform. As a part of the Dodd-Frank Wall Street Reform and Consumer Protection Act, there is a section titled "Nonadmitted and Reinsurance Reform Act of 2010," which deals with reform of multistate surplus lines transactions and reinsurance. I hope you enjoy the article, and I wish the best of luck to surplus lines brokers who are trying to figure out whether the reforms make things better, worse or just different.

The article "One Solution for 300 Rules," by **Hugh Carter Donahue, Ph.D.,** is a follow-up to "It's a Brave New World," which we published in the June 2010 Regulatory & Legislative Interest Group newsletter. It provides some insightful commentary on how the actions of the financial sector impact insurers through the assets they hold. It is an interesting commentary on the civil war between Federal Reserve Chairman **Ben S. Bernanke, Ph.D.,** and financial heavyweight **Jamie Dimon,** chairman and CEO of JPMorgan Chase, over whether the financial sector needs oversight or freedom to do what it did in the past.

My daughter was recently involved in a car accident. When I asked her what happened, I received an interesting story about two very distracted drivers. It seems that my daughter was holding a cup of coffee she had just purchased at Dunkin' Donuts® — my favorite coffee by the way — and talking to her passenger when her car was hit by one driven by someone who was speeding and talking on a cell phone. Sounds like an accident waiting to happen at any moment. With that in mind, I am sure you will enjoy our distracted driver article. You will be amazed at what types of distractions occur (or maybe you won't be as surprised as I was).

In trying to promote the Regulatory & Legislative Interest Group (RLIG) Committee — and CPCU Society interest groups in general — the RLIG Committee has exhibited a few times: at the NAIC Summer National Meeting in Seattle, Wash., from Aug. 13–17, 2010; the NAIC Fall National Meeting in Orlando, Fla., from Oct. 18–21, 2010; and at the All Industry Day sponsored by the CPCU Society Kansas City Chapter on Nov. 12, 2010.

On April 5, 2011, we sponsored a CPCU Society webinar titled "2010 Financial Review and Current P&C Hot Topics." The webinar highlighted the financial condition of the property-casualty (P-C) industry, focusing on 2010 results, and examined major P-C topics and trends affecting the industry. The webinar provided an overview of what is occurring in the House and Senate from a federal standpoint, including an update on NAIC initiatives discussed at the NAIC Spring National Meeting held March 26–29 in Austin, Texas. Attendees learned more about the important issues in the news and asked questions on the various topics presented.

There sure have been various legislative activities introduced this year on the federal level and in many states. For those of you involved in monitoring law changes, the Regulatory & Legislative Interest Group Committee members certainly understand how busy you are. Through the end of May, there have been more regulatory and legislative items introduced than for all of 2010. Although the number of enactments is more than half of last year, there still is seven months of the year to introduce and enact more items on a state-by-state basis. In 2010, there were 9,358 items introduced and 3,896 enacted. In May 2011, there were 10,233 introduced and 1,995 enacted, year to date.

On a federal and state basis, here follows a short list of the various items of major importance. Please feel free to contact us if there are items on this list with which you're not familiar. This is not a comprehensive list, but one I thought you might be interested in. Perhaps one or more of these will play a major role during the "'GAME ON!' — Show Me the Money … Test Your Insurance Knowledge" session in Las Vegas.

Some of the major items include:

- National Flood Insurance Program.
- Credit-based insurance scores.
- Consumer Protection Agency.
- Federal Insurance Office.
- National Association of Registered Agents and Brokers II.
- Nonadmitted Insurance Multistate Agreement.
- Surplus Lines Insurance Multi-State Compliance Compact.
- Reinsurance modernization.
- Distracted driving.

- Insurance exchanges (not meant to include health insurance exchanges).
- Financial Stability Oversight Council.

The Regulatory & Legislative Interest Group Committee website, http://rl.cpcusociety.org/, provides hyperlinks to state legislative calendars, and provides hyperlinks to websites of the House Committee on Financial Services; the Senate Committee on Commerce, Science and Transportation; and the Senate Committee on Banking, Housing & Urban Affairs. These three House and Senate committees are the primary committees for introducing and enacting laws affecting insurance on the federal level. The RLIG Committee also highlights important items on our LinkedIn website. Please let us know if you have any suggestions for adding information or links to our website or to LinkedIn.

Within the NAIC, there are several items in development for property-casualty. There are several items specifically for consumers. A consumer's guide for automobile insurance was recently updated. A consumer's guide for earthquake coverage is being developed and will more than likely be approved later this year. A newly formed Transparency and Readability of Consumer Information Working Group will study and evaluate actions to help improve the capacity of consumers for personal lines products to comparison-shop on the basis of differences in coverage.

At a high level, the above is a quick review of items the Regulatory & Legislative Interest Group Committee is involved with as well as what is occurring in the property-casualty area within the United States. I hope you will review the RLIG website and join us on LinkedIn.

I encourage you to write an article for a future issue of this newsletter. Whether it's through writing an article, posting something on LinkedIn or sending an email, we would like to hear from you.

I will listen to your needs and act as a champion to implement your plans of what you would like the Regulatory & Legislative Interest Group to do. My email is jbieniek@NAIC.org, and my phone number is (816) 783-8226. Drop me note or give me a call with your comments and suggestions. ■

2011 Annual Meeting and Seminars

Oct. 22–25 • Las Vegas, Nev.

The Regulatory & Legislative Interest Group Presents

'GAME ON!' — Show Me the Money … Test Your Insurance Knowledge

Oct. 23 • 2:45–4:25 p.m.

This seminar uses a game show format to test individual and team knowledge, with the top teams winning prizes/gifts. Attendees will explore topics such as recent legislative and regulatory changes, general compliance facts, the history of insurance regulation, and policy forms and coverages. Presenters will provide additional context and learning dialogue around each question to ensure participants leave with expanded knowledge of our regulated industry. ***Filed for CE credits.***

Moderators/Game Show Hosts: **Joseph E. Bieniek, CPCU, AIE, CCP,** National Association of Insurance Commissioners; **Eric C. Nordman, CPCU, CIE,** National Association of Insurance Commissioners.

Presenters: **Martin H. Alpert, CPCU, J.D., ARM,** Hinz Claim Management Inc.; **Aaron L. Brandenburg, CPCU, ARM,** National Association of Insurance Commissioners; **James Fryer, CPCU, Ed.D.,** Pearson VUE; **Bradley K. Harmes, CPCU, ARM-P,** Marsh Public Entity Practice; **Rick Jones, CPCU, ARM, AFIP,** SCF Premier Insurance Company; **David M. Keleher, CPCU, CIC, ARM,** National Association of Insurance Commissioners; **Aaron E. Lunt, CPCU, J.D., ARe,** Zurich and Farmers Financial Services; **Elizabeth C. Lupetini, CPCU, CLU, RPLU,** Unitrin Direct; **Loren D. McGlade, CPCU, ARM, ARe,** Chartis U.S.; **Donald P. Roinestad CPCU, CLU, CIC,** Unitrin Direct; **Robert D. Stevens, CPCU, CLU, ChFC,** Crawford & Company; **Christine A. Sullivan, CPCU, MBA, AIM,** Allstate Insurance Company; and **Richard E. Wise, CPCU, ARC, AIC,** Zurich North America.

Surplus Lines Reform Efforts

by Eric C. Nordman, CPCU, CIE

Eric C. Nordman, CPCU, CIE, is currently the director of regulatory services at the National Association of Insurance Commissioners (NAIC). He directs the regulatory services division staff in a wide range of insurance research, financial and market regulatory activities, supporting NAIC committees, task forces and working groups. He has been with the NAIC for 20 years. Prior to his appointment as director of the regulatory services division, Nordman was director of research and, before that, the NAIC's senior regulatory specialist. Previously, he was with the Michigan Insurance Bureau for 13 years. Nordman earned a bachelor's degree in mathematics from Michigan State University. He is a member of the CPCU Society Kansas City Chapter.

Background

The tale I am about to tell started many years ago. Long ago, someone noticed that there were inefficiencies in the way that states went about taxing and regulating surplus lines transactions. But before we start our story, perhaps we need to be sure that we all are on the same page regarding some unique terminology used to describe the participants in what is known as the surplus lines market.

Generally, insurance regulators and state legislators prefer that citizens buy insurance coverage from insurers that are licensed or authorized to do business in their respective states. The reason for this is to ensure that state financial solvency oversight and other consumer protection laws fully apply to protect the interests of the insurance buying public. Occasionally, the licensed insurers — collectively known as the "admitted market" — cannot or will not sell insurance coverage for every type of event or to every person or business that seeks coverage.

There are a couple of ways to address the lack of affordable or available coverage. The state legislature may decide that a governmental entity might be the best way to meet the needs of constituents. States have established residual market entities in a number of forms to address availability or affordability needs. They are generally found for auto insurance, property insurance and workers compensation insurance. There are a few residual market mechanisms that provide other forms of liability insurance — generally medical malpractice.

There is another way to address availability and affordability concerns without creating a governmental insurance mechanism. Enter the surplus lines insurer. A surplus lines insurer is simply an insurer that is, under certain circumstances, allowed to sell insurance in a state without benefit of a license to do so. The surplus lines insurers are collectively known as the "nonadmitted market." The nonadmitted market serves as a safety valve for the admitted market and helps make certain that every person and business have coverage available to meet their risk management needs.

State laws and regulations dictate the circumstances under which a citizen or business may ignore the admitted market and seek coverage from the nonadmitted market. Often, these laws require the use of a specialized insurance broker, known as a surplus lines broker. The resident surplus lines broker is generally required to have a license as a property-casualty producer, and some states have seasoning requirements for them.

When approached for coverage, the surplus lines broker must conduct a diligent search to determine if coverage is available from the admitted market before placing it with a surplus lines insurer. The surplus lines broker must also determine if the particular surplus lines insurer is eligible to write the coverage sought. Further, the broker is often responsible for filing attestations and transactional information with the state insurance departments, stamping offices or tax authorities.

The states collect the surplus lines premium tax from the surplus lines broker rather than the insurer for one obvious reason — the broker has a license with the state while the surplus lines insurer does not. In other words, the state insurance regulator has clout over the surplus lines broker that it might not have over the surplus lines insurer.

A stamping office is an entity created by state law that receives and processes transactional information, checks for compliance with state due diligence and placement requirements, and, in some cases, processes premium tax filings. The 14 states that have stamping offices use them in a variety of ways. But it is safe to say that the role of stamping offices is to monitor the surplus lines markets and prepare reports for regulators and the public.

States also have regulations regarding which insurers are eligible to write insurance on a nonadmitted basis. Eligibility requirements revolve around evidence of good reputation and financial integrity. They may include minimum capital and surplus requirements. States often publish their own "white lists" of approved surplus lines insurers. Also, the National Association of Insurance Commissioners (NAIC) publishes a "Quarterly Listing of Alien Insurers" that most states use to identify non-U.S. insurers that are deemed to be acceptable surplus lines writers. These non-U.S., or alien insurers, are subject to certain trust fund requirements for the protection of U.S. policyholders. The trust fund requirements have long been a bone of contention for those subject to them.

Surplus lines insurers have some advantages over licensed insurers. The principal benefits are freedom from rate and policy form filing requirements and a prohibition from their participating in state guaranty funds. While these are beneficial to the surplus lines insurer, they can be detrimental to the policyholder. Thus, state laws often require policyholder warnings that the purchase is being made from an unlicensed insurer, that not all the state's consumer protection laws may apply and that there is no guaranty fund coverage available.

A Historical Perspective

Problems with the diversity of state regulatory approaches began to be discussed in earnest in the 1980s. In 1969, the NAIC adopted the Unauthorized Insurers Model Act. In 1983, the NAIC adopted the Model Surplus Lines Law and the Model Nonadmitted Insurance Act. Certain elements of these models pertained to premium taxation and the thorny issue of how to allocate premium for multistate risks.

The process required a quarterly reporting and payment of taxes due. An amendment to the Model Surplus Lines Law to address concerns over the complexity of the process was adopted in 1985. By late 1989, there were complaints that the amendment was not working because only one state had adopted it and another was considering changing the way it taxed surplus lines premiums.

In the 1990s, amid further complaints from surplus lines brokers about the difficulties associated with figuring out what to pay each state when faced with a multistate risk, the NAIC again debated and adopted model legislation. Adopted in 1994, the Nonadmitted Insurance Model Act replaced the three earlier model laws. It was intended to provide a framework for consumer protection that encouraged the use of the admitted market but permitted the placement of coverage with nonadmitted insurers for certain lines of business after a diligent search of the admitted market.

In 1995, a corresponding model regulation was adopted that specifically addressed the allocation of premium tax for surplus lines and independently procured insurance. The Allocation of Surplus Lines and Independently Procured Insurance Premium Tax on Multi-State Risks Model Regulation provided a framework for calculating and reporting premium tax obligations for states that adopted the model law and regulation. It also provided a system of reciprocity for those states that wished to adopt both the model law and the model regulation. The problem for surplus lines brokers would have been solved if only all the states had adopted both the model law and the model regulation with its specific allocation and reporting forms.

That was not to be the case. Roughly 60 percent of the states adopted the Nonadmitted Insurance Model Act or its equivalent. However, less than 10 percent of the states adopted the Allocation of Surplus Lines and Independently Procured Insurance Premium Tax on Multi-State Risks Model Regulation. As a result, before the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), surplus lines brokers faced significant challenges in attempting to be compliant with the various state regulatory requirements related to calculating and paying the appropriate premium taxes for multistate surplus lines placements.

Surplus Lines Reform

The reader is probably curious to know what the Dodd-Frank law has to do with surplus lines transactions. There is a section of Dodd-Frank called the Nonadmitted and Reinsurance Reform Act of 2010 (NRRA), which deals with reform of multistate surplus lines transactions and reinsurance. For the remainder of this article, I will limit myself to the surplus lines portion of the NRRA.

Most of NRRA's provisions go into effect in July 2011, and states effectively had until June 2011 to become part of a nationwide solution or risk losing valuable surplus lines premium tax revenues to the "home state" of the insured on a multistate placement.

It is important that everyone understands what the NRRA requires. The NRRA grants exclusive authority to the insured's home state to require the payment of surplus lines premium taxes related to a placement of coverage with a nonadmitted insurer. It does offer a

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Surplus Lines Reform Efforts

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solution that would authorize states to share surplus lines premium taxes. It says that states may enter into a compact or otherwise establish procedures to allocate among the states the premium taxes paid to an insured's home state.

There is also a statement of congressional intent in the NRRA. It says, "The Congress intends that each state adopt nationwide uniform requirements, forms, and procedures, such as an interstate compact, that provide for the reporting, payment, collection, and allocation of premium taxes for nonadmitted insurance consistent with this section."

The NRRA also restricts state regulatory authority in several ways. Subject to a workers compensation exception, the authority of states to regulate the placement of nonadmitted insurance is limited to the laws and regulations of the home state of the insured. Further, no state other than the insured's home state may require a surplus lines broker to be licensed to sell, solicit or negotiate nonadmitted insurance. There also is a provision that prohibits a state from collecting any fees related to licensing of an individual or entity unless the state participates in the NAIC's Producer Database. This latter provision does not apply until July 21, 2012.

While this article does not attempt to discuss all the provisions of the NRRA in detail, I believe it covers enough of it to allow the reader to understand what has taken place since the law was adopted last July.

Since the NRRA was adopted, state insurance regulators and legislative organizations have been vigorously discussing and debating how best to deal with the challenges of the NRRA in the tight time frame required by the Act. This has resulted in two separate and distinct proposals to become the "nationwide uniform requirements, forms, and procedures" suggested by Congress.

The NAIC Executive Committee appointed a Surplus Lines Implementation (EX) Task Force at its Summer National Meeting in August 2010 and charged it with developing state-based solutions for addressing the surplus lines part of the NRRA. Early discussion led to a consensus among state insurance regulators. They all agreed it is imperative to preserve the ability of states to receive surplus lines premium taxes in much the same way they do today. In other words, regulators want to ensure states continue to receive taxes based on the risk or exposure located within their borders.

Early in its deliberations, the task force recognized that certain legislative changes were needed for states to participate fully in a nationwide system for premium tax allocation and disbursement. The task force suggested that states should adopt a law containing a uniform definition of "home state" consistent with the definition contained in the NRRA. States should amend their laws to provide for the authority to tax 100 percent of the gross premium of a surplus lines policy for which that state is the home state. States should change their laws to provide for the authority to allocate on a reciprocal basis a portion of the premium tax related to the percentage of the property or risk in those other states. States agree that a uniform method of reporting in conjunction with tax collection and allocation is necessary.

Insurance regulators have reached out to legislators, stamping offices, revenue departments and other state agencies affected by the NRRA. The task force studied several possible structures as part of its due diligence. The task force evaluated the Surplus Lines Multi-State Compliance Compact, or SLIMPACT. It seems that the principal drafters of SLIMPACT included the National Association of Professional Surplus Lines Offices Ltd. (NAPSLO) and other industry trade representatives.

In its opening paragraph, the SLIMPACT Executive Summary says the interstate compact "was drafted with input from over 60 insurance professionals representing various state regulators, tax officials, legislators, stamping offices, brokers and trade associations." A second version of SLIMPACT, called "SLIMPACT-LITE," was considered at the National Conference of Insurance Legislators (NCOIL) 2010 Annual Meeting. Following NCOIL's adoption of SLIMPACT-LITE, it was joined in support by the Council of State Governments (CSG) and the National Conference of State Legislatures (NCSL).

The NAIC task force also evaluated the applicability of the International Fuel Tax Agreement (IFTA) as a model approach. IFTA is an agreement between the U.S. states and Canadian provinces that relates to taxation of motor carriers operating in two or more jurisdictions. A participating motor carrier files a quarterly fuel tax report that is used to determine whether the motor carrier owes additional taxes or is due a refund. The report is also used to redistribute the taxes from collecting states to those where the tax is due. Alaska, Hawaii and the Canadian territories do not participate in IFTA.

After considering a formal interstate compact approach, the task force opted to develop an interstate agreement similar to IFTA. The proposed agreement is known as the Nonadmitted Insurance Multi-State Agreement (NIMA). It would allow participating states to share surplus lines premium tax revenues in ways consistent with the NRRA.

NIMA would establish a central clearinghouse for reporting, collecting and distributing surplus lines premium taxes. The clearinghouse would generally be used for multistate placements, but states would have the option of using the clearinghouse for single-state placements, too. Surplus lines brokers and individuals independently procuring nonadmitted insurance would have access to a Web-based software program for ease of filing and reporting. NIMA would prescribe uniform allocation formulas and reporting methods.

A role for stamping offices, in those states that have them, would be preserved. States would be required to establish a "blended tax rate" encompassing applicable taxes and fees across lines of business. Development of a blended tax rate is considered crucial to streamlining the compliance obligations of the surplus lines brokers.

NIMA is not a broad regulatory compact, and it does not go as far as some regulators and representatives of the insurance industry may have preferred. However, NIMA does provide a means for preserving something close to the status quo where premium taxes are concerned. This was considered crucial to task force members. There is also a legitimate concern about the ability of all states to enter into a formal interstate compact in the short time frame allowed by the NRRA.

The NRRA grants exclusive authority to the insured's home state to require the payment of surplus lines premium taxes related to a placement of coverage with a nonadmitted insurer.

What Happens Next?

So, where are we? At the end of the day, there is a July 21, 2011, deadline for things to happen. What is uncertain is what things will actually take place. We know that for states that do not either join SLIMPACT-LITE or NIMA, they will only be able to collect surplus lines premium taxes for those single-state policyholders within their borders or multistate policyholders for which they serve as the home state. They will not be able to share in any premium tax revenues from other states.

After that, things become a bit murkier. If two or more states enter into the agreement contemplated by NIMA, they will be able to share premium tax revenues in accordance with the terms of NIMA. If many states enter into the agreement, then things improve both for the states and the surplus lines brokers. The states preserve their current revenue flow. The surplus lines broker gains from the ability to make a single payment to a clearinghouse that covers tax obligations in multiple states using blended tax rate and a convenient Web-based application to do all the math.

NIMA is one part of state implementation of a surplus lines regulatory reform. NIMA allows states to address the most pressing issue of preserving surplus lines premium tax revenue within the very short period of time provided by Congress. As for other areas of surplus lines regulatory reform, the work of the NAIC task force will be ongoing.

Things become even more complicated when SLIMPACT-LITE is involved. It is a more complex interstate contractual agreement than NIMA, as it contains numerical thresholds that trigger the creation of the compact commission. While two or more states can enter into the interstate compact to make it an effective contract, the compact commission is not effective until the compact has been adopted by 10 states or by states representing 40 percent or more of the U.S. surplus lines market. Thus, one might find that a number of states have adopted the interstate compact; however, the compact is ineffective because the numerical thresholds have not been met. It is presumed that these states would be in the same place as if they had not enacted the interstate compact.

While some insurance regulators have supported SLIMPACT-LITE, most regulators believe the SLIMPACT-LITE proposal goes too far. Some object to the establishment of a central commission with the authority to promulgate rules that could preempt contrary state laws in ways not necessarily required by the NRRA. While NRRA authorizes and provides incentives to states to put in place a nationwide uniform system for

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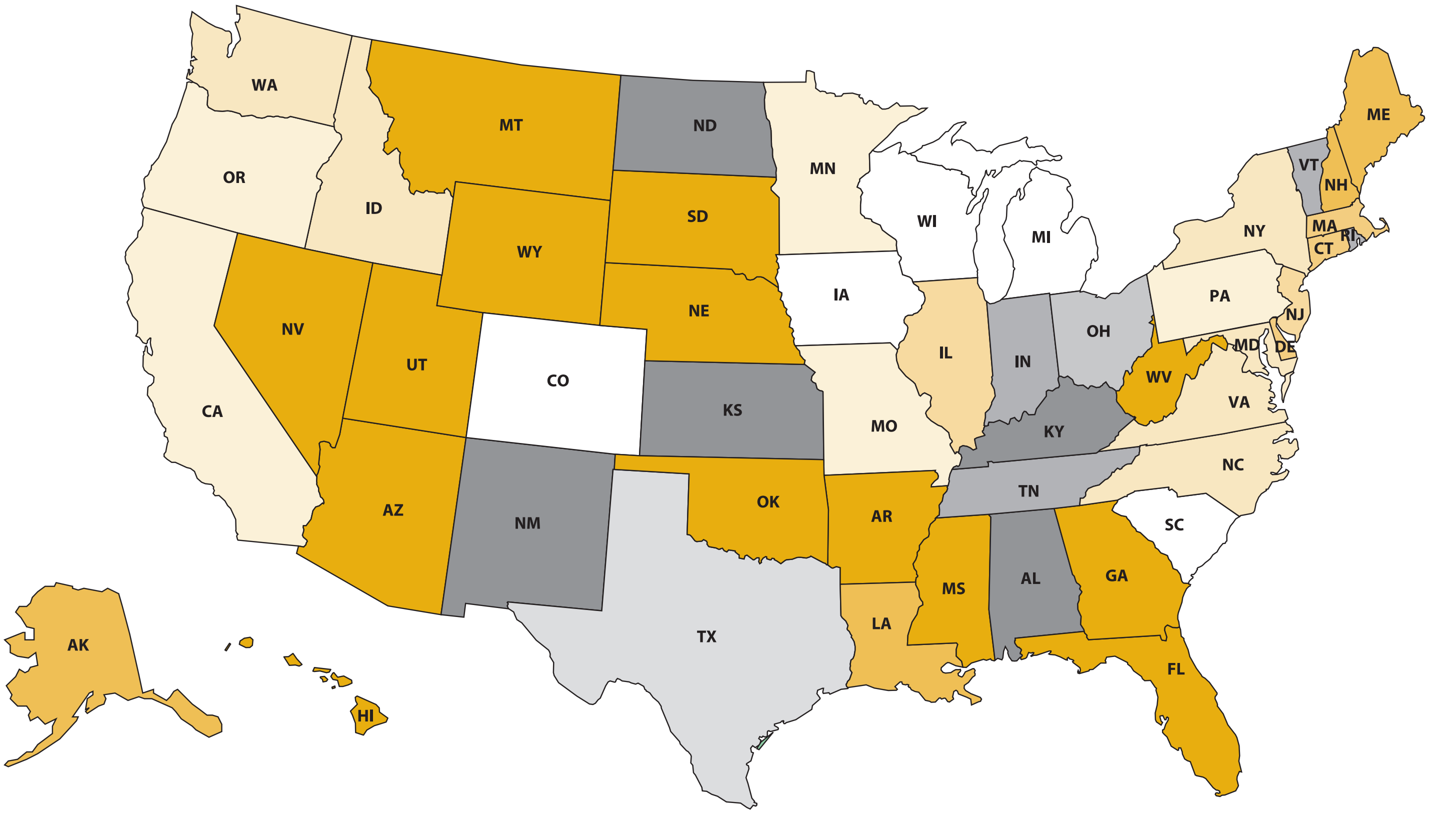

tax allocation, states can agree to do this in ways that do not mandate ceding authority to a compact commission that could preempt state laws.

Some regulators object to the governance structure of SLIMPACT-LITE. Under the most recent iteration, SLIMPACT would establish an executive committee and an operations committee. By SLIMPACT's terms, the operations committee must include individuals with extensive experience and/or employment in the surplus lines business, including insurance industry professionals, law firms, regulators and surplus lines stamping offices. In fact, stamping offices must be appointed to the operations committee if a state on the committee uses such an office. While the executive committee oversees the operations committee, the executive committee must accept the determinations and recommendations of the operations committee unless good cause is shown otherwise. It is also not clear if the executive committee will comprise regulators, or the persons they regulate or a combination of the two.

In another development, NCOIL has teamed up with the CSG and the NCSL to write an open letter to Congress urging Congress to extend the deadline for compliance with the surplus lines provisions of the NRRA from July 21, 2011, to July 21, 2012. This request has received a lukewarm reception, at best, on Capitol Hill.

Early in its deliberations, the task force recognized that certain legislative changes were needed for states to participate fully in a nationwide system for premium tax allocation and disbursement.

At its March 6, 2011, meeting, NCOIL adopted a Resolution Urging Congress to Extent the Effective Date for Nonadmitted Insurance Provision of the Dodd-Frank Act. In its news release, NCOIL said that SLIMPACT-LITE is being actively considered in 13 jurisdictions.

This paragraph will provide a progress report, as of June 15, 2011. The states of Arizona, Arkansas, Florida, Georgia, Hawaii, Mississippi, Montana, Nebraska, Nevada, Oklahoma, South Dakota, Utah, West Virginia and Wyoming have approved legislation that would authorize the commissioner to enter into NIMA or an interstate agreement or compact.

In four states (Alaska, Louisiana, Maine and New Hampshire), similar legislation has passed the legislature and is awaiting the governor's signature. In three states (Connecticut, Delaware and Massachusetts), legislation that would authorize the commissioner to enter into NIMA or an interstate agreement or compact has passed one house of the legislature. There are two states (Illinois and New Jersey) where legislation is pending that would authorize the commissioner to enter into NIMA or an interstate agreement or compact. The state of Texas has a statute in place that would allow its comptroller to enter into an interstate agreement or compact.

Five states (Alabama, Kansas, Kentucky, New Mexico and North Dakota) have adopted SLIMPACT. Four states (Indiana, Rhode Island, Tennessee and Vermont) have approved SLIMPACT with a fallback option if SLIMPACT is not operational. Ohio has approved enabling legislation with the apparent intent of joining SLIMPACT. New York has SLIMPACT legislation pending; however, it should be noted that New York previously enacted NRRA-conforming legislation. Further, the SLIMPACT legislation is also pending in Texas, although Texas already has a statute in place that would allow its comptroller to enter into an unspecified interstate agreement or compact.

There are six states (Idaho, Maryland, New York, North Carolina, Virginia and Washington) that have approved NRRA-conforming legislation without seeking authority for NIMA, SLIMPACT or something similar. The states of California, Minnesota, Missouri, Oregon and Pennsylvania have pending NRRA-conforming legislation only.

Stay tuned. It looks as if we are in for a race. Only time will tell if NIMA or SLIMPACT-LITE prevails — or if both come into being. In the meantime, we need to be ready for a variety of outcomes. Over the short-haul, surplus lines brokers might even be faced with more complexities than they had before the reform effort. They will probably have to deal directly with each state on single state placements. They may have to deal with a home state, a NIMA clearinghouse or a SLIMPACT-LITE compact clearinghouse depending on primary location of the policyholder. Only time will tell. ■

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Regulatory and Legislative Interest Group Committee

Mission Statement

In a regulated industry where "compliance matters," we provide information and insight on the laws and regulations affecting the business of insurance. We promote healthy discussion and dialog on the rapidly evolving federal and state regulatory insurance arena.

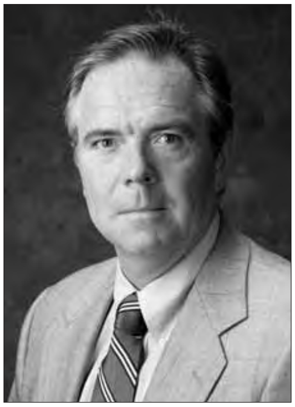
Vision

The Regulatory and Legislative Interest Group strives:

- To be the first place Society members choose to learn about proposed or recently enacted insurance laws and regulations.
- To be recognized within the Society as one of the premier interest groups.
- To provide relevant regulatory information about all countries, including those that may impact United States marketplaces.
- To be a trusted source of information about the various United States insurance markets.
- To provide a forum for discussion on pertinent regulatory or legislative issues.

One Solution for Three Hundred Rules

by Hugh Carter Donahue, Ph.D.



Hugh Carter Donahue, Ph.D., develops communications applications, consults on communications markets and policies, and advises energy, telecommunications and high tech firms on regulation and business development. He is the author of *The Battle to Control Broadcast News* and numerous articles and essays. Donahue earned a doctorate in communications and policy analysis from the Massachusetts Institute of Technology. He is an adjunct professor of history at Rowan University in New Jersey. Donahue can be reached by email at hcd@dca.net.

Editor's note: This article is reprinted with permission.

JPMorgan Chase Chairman and CEO Jamie Dimon's dustup with Federal Reserve Chairman Ben Bernanke over the best route to prosperity at a bankers' conference in Atlanta was remarkable for what it overlooks fully as much as for the distinct pathways to recovery each titan of finance champions.

For Dimon, regulatory costs of 300 odd rules and regulations, under development to implement Dodd Frank financial industry reforms, are disproportionate to intended benefits. Not only does rule-making slow investment and recovery, the variety and likely duplication of rules across regulatory silos will raise compliance costs once regs are in place. Quite sensibly, Dimon queries whether regulators are evaluating regulatory costs to ascertain whether the uncertainty associated with rule-making and the duration of time required for implementation are counterproductive and slowing recovery.

All or most of the bad apples are gone, Dimon contends. Institutions and practices, which spawned the asset crisis, are out of business, under federal oversight or no longer acceptable. Those left standing, like JPMorgan Chase, passed stress tests and are now able to spur investment, but for the uncertainty surrounding forthcoming regulation. While JPMorgan Chase's self-interest is palpable in Dimon's contentions, there's more than a kernel of truth in his concerns.

For Bernanke, rules have to be crafted meticulously and can't be avoided, for asset crisis wreckage impels no less. As Fed Chair, he's tasked committees and groups to fine-tune rules so institutions such as smaller banks bear fewer and lower regulatory costs than the five large banks dominating finance.

Dimon and Bernanke each define and then they see. As a banker keen on shaping investment, Dimon sees regulatory costs. As overseer of the banking system, Bernanke sees obligations. Neither fully discerns what's in plain sight.

Dimon and Bernanke overlook information technology and system architecture that's already in hand as an efficient market framework. To his credit, Bernanke acknowledges that federal regulators are searching for a framework. "We're moving as expeditiously as we can to develop a new framework … consistent with good practice but which does not unnecessarily impose costs or unnecessarily constrict credit," the Fed Chairman told bankers.

In November 2008, the Congressional Research Service (CRS) reported to Congress that Marketcore, an intellectual property development company, perfected a framework for "(1) …. disclosure and reporting of comprehensive data and analytics pertaining to all financial instruments, including loans, lines of credit, other financial products, as well as insurance, reinsurance and securitized insurance risks; and (2) a transaction platform, or other data highway, such as the Internet, in which financial products are bought and sold, and where detailed data on the composition of the assets and of the transactions are collected, stored, and displayed."

Dimon and Bernanke overlook information technology and system architecture that's already in hand as an efficient market framework.

"Transparent information about the transaction details would keep market participants honest, while allowing all parties a reasonable expected profit from the transaction … ," the CRS study finds. "Transparency in the pricing and terms of securities is considered … essential for

financial market efficiency. By definition, transparent financial markets provide accurate information to allow for the discovery of transaction prices, as well as terms on securities and financial instruments of all types. It is considered important that this 'real time' information be readily available to everyone, encouraging market participation," CRS observes.

The Marketcore framework is friendly to all stakeholders: consumers, bankers, exchanges, brokers, agents, investors and regulators. It merely awaits adoption for efficient implementation of Dodd Frank legislation with negligible regulatory costs; that is, the framework enables profitable compliance with the upcoming 300 rules. Increasingly standardized platforms will enable all market participants to discern the net present value of risk instruments and investment vehicles — and this is what defines transparency.

With a standard, universal framework for risk assessment, investor confidence would return, the economy will attract investment, aggregate demand will expand, consumer welfare will flourish and vibrant markets will supersede stagnant economy.

The framework represents vastly more than a vehicle to manage regulatory costs. Let's leave behind institutional inertia common alike to major bankers and state and federal regulators and embrace information technology risk clarifiers to promote the American national interest. ■

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Distracted Driving

by Eric C. Nordman, CPCU, CIE

One cannot pick up a newspaper or magazine without reading about distracted driving. Wait a minute — shouldn't I be using an Android or a Kindle, an iPhone or a Blackberry, to read this news? Perhaps not … particularly if I happen to be behind the wheel.

The U.S. Department of Transportation (DOT) has joined the fight against the serious and potentially life-threatening incidences of distracted driving. In fact, there is an informative website[1] devoted to the effort. According to the DOT, distracted driving comes in three flavors — visual, manual and cognitive. The DOT defines distracted driving as "any non-driving activity a person engages in that has the potential to distract him or her from the primary task of driving and increase the risk of crashing."[2] Visual distractions involve anything that takes your eyes off the road.[3] A manual distraction is something that causes you to take your hands off the wheel.[4] A cognitive distraction is something that causes you to take your mind off what you are doing.[5]

Activities such as smoking, eating, drinking, grooming, tuning the radio and even reading a newspaper have been around for a long time. With the advent of all the new electronic gadgets, it is only recently that distracted driving has moved from an annoyance to an epidemic. According to the National Highway Transportation Safety Administration (NHTSA), more than 20 percent of injury accidents in 2009 involved some form of distracted driving. Further, according to the NHTSA, cellphones were involved in 18 percent of fatalities in distraction-related incidents. A University of Utah study points out that using a cellphone while driving delays a driver's reactions as much as having a blood alcohol concentration at the legal limit of .08 percent.

There are other forms of distracted driving. Experience has shown us that pets riding in cars can be distracting. In fact, a recent survey by AAA and Kurgo found that one out of three dog-owning drivers admitted to being distracted by his or her dogs. The survey revealed that 60 percent of drivers engaged in at least one of three distracting behaviors. Roughly 7 percent admitted to giving the dogs food or water while driving, 55 percent engaged in petting their dogs and 20 percent allowed their dogs to sit in their lap.

There has been some state legislative activity on distracted driving. As of March 2011, 28 states and the District of Columbia ban all cell-phone use by novice drivers; eight states ban handheld cellphones for all drivers; and 18 states and the District of Columbia prohibit bus drivers from using a cellphone when passengers are present. States have also addressed texting. Thirty states, the District of Columbia and Guam ban text messaging for all drivers; an additional eight states prohibit text messaging by novice drivers; and two states restrict school bus drivers from texting while driving. Some local jurisdictions may have additional regulations; however, Florida, Kentucky, Louisiana, Mississippi, Nevada and Oklahoma prohibit localities from enacting such laws. So far, there is no state that bans all cellphone use — handheld and hands-free — for all drivers.[6]

The nation's police agencies participate in a data-sharing system called the Fatality Analysis Reporting System (FARS). According to FARS data, "the proportion of fatalities reportedly associated with driver distraction increased from 10 percent in 2005 to 16 percent in 2009. During that time, fatal crashes with reported driver distraction also increased from 10 to 16 percent. The portion of drivers reportedly distracted at the time of the fatal crashes increased from 7 percent in 2005 to 11 percent in 2009. The under-20 age group had the highest proportion of distracted drivers involved in fatal crashes (16 percent). The age group with the next greatest proportion of distracted drivers was the 20- to 29-year-old age group —13 percent of all 20-to 29-year-old drivers in fatal crashes were reported to have been distracted."[7]

With statistics like these, insurers are starting to take notice. They see accident frequency rising, particularly accidents involving use of cellphones and texting. There have also been some creative solutions from the private sector targeted

at distracted driving. There are several in the realm of telematics.

Telematics is simply shorthand for devices that merge telecommunications and information. Perhaps the best known telematics device is OnStar, which is a device that merges a digital telephone signal with a Global Positioning System (GPS). OnStar also has the capability of alerting first responders in the event of an accident by tying into the GPS device and the air bag sensors. In addition, the GPS device records information that helps with claim settlement for insurers.

Insurers are beginning to use telematics in pricing. Early efforts were pioneered by Progressive Insurance, which received a patent on a pay-as-you-drive (PAYD) system.[8] PAYD systems generally use a GPS device. The typical PAYD system integrates traditional insurance risk-classification factors with a rate-per-mile factor. The insurers use the GPS device to track mileage. The GPS device is also capable of tracking when and where the vehicle is driven. Certain insurers have incorporated some of these characteristics into their pricing models. Rapid starts and stops can be tracked, too. Insurers are challenged to overcome some privacy concerns when using the GPS device. As a result, PAYD systems generally stick to basics.

Fleet owners are beginning to use telematics to dispatch and monitor trucking fleets. The GPS provides useful information to keep loads on track and drivers on the right path. The GPS has also provided useful information in tracking where trailers are located once disconnected from their rigs.

Recently, a new telematics device was developed by Global Mobile Alert™.[9] It employs the very device (a cellphone) that causes the most significant distracted-driving problem to solve it. I am referring to talking on a cellphone and texting while driving — both known distractions. It also works for other types of distractions. Global Mobile Alert has designed a mobile application that works on android devices. When activated, the application interacts with the driver by "interrupting" the distraction. It does so by sending an audible warning signal that causes the driver to forget the distraction and get back to the task at hand — namely, driving.

The alert works by sending an audible signal to the driver when the driver is approaching a traffic signal, a railroad crossing or a school zone. At its core, the application uses a GPS feature. The GPS knows the locations of traffic lights, railroad tracks and schools, and sends a signal as the driver approaches any of these locations. It offers some hope that accidents can be reduced, particularly at major intersections and railroad crossings, where the severity of accidents is higher. Its sensitivity to school zones offers hope that many innocent lives can be saved. Global Mobile Alert is a breakthrough that takes a mobile phone from a distraction to a guardian.

Other telematics devices are intended to measure and react to driver fatigue. The most common type is where machine vision is used to compute the driver's direction of gaze in real time. The goal is to provide instant feedback if a driver is inattentive. Some vehicle manufacturers have deployed first generation driver fatigue measurement devices. This type of device is often found on high-end vehicles.

So what's next? The NHTSA has an extensive program aimed at distracted driving. Its approach includes four specific initiatives. The first initiative is to improve understanding of the problem. In that initiative, NHTSA will try to improve police reporting; analyze crash data; continue observational studies; publish observational protocols; plan for analysis of items that increase understanding of sources and effects of distracted driving; assess use of new technologies; assess cellphone interfaces; and evaluate the distractive effect of various manual tasks.

The second NHTSA initiative is to reduce the workload demands on drivers when using in-vehicle technologies. To accomplish the initiative's goals, there will be a review of current guidelines, development of distraction and usability metrics, and development of new guidelines based on lessons learned from the first two tasks.

The third NHTSA initiative involves steps to keep distracted drivers safe. Several efforts will be needed to address this initiative. NHTSA plans to improve crash warning interfaces, quantify the benefits of crash warning systems, and assess distraction monitoring systems and the effectiveness of cellphone filters.

The fourth initiative is to recognize risks and consequences. In it, NHTSA will evaluate current laws and high-visibility enforcement efforts; develop targeted media messages; draft and publish sample laws for use by states; publish guidance for the federal ban on text messaging for its employees; assess the potential of implementing education and training programs; and develop program resources through the World Health Organization.

The goal of NHTSA and those interested in public safety is to eliminate distraction-related crashes. If this goal can be reached, the public will be safer, and there will be a positive impact on insurance-costs. It is a winning strategy for everyone. ■

Endnotes

(1) http://www.distraction.gov/

(2) http://www.distraction.gov/stats-and-facts/index.html

(3) Ibid.

(4) Ibid.

(5) Ibid.

(6) http://www.ghsa.org/html/stateinfo/laws/cellphone_laws.html

(7) Ibid.

(8) Progressive Auto Insurance. U.S. Patent #5,797,134.

(9) http://www.globalmobilealert.com/

How Safe Is Your Phone?

by Eric C. Nordman, CPCU, CIE

In recent years, most businesses and households have converted from traditional telephone networks to new, less expensive Internet-based telephone service. According to the Federal Communications Commission, "Voice over Internet Protocol (VoIP) services convert your voice into a digital signal that travels over the Internet. If you are calling a regular phone number, the signal is converted to a regular telephone signal before it reaches the destination. VoIP will allow you to make a call directly from a computer, a special VoIP phone or a traditional phone connected to a special adapter. In addition, wireless 'hot spots' in locations such as airports, parks and cafes allow you to connect to the Internet and may enable you to use VoIP service wirelessly."[1]

This sounds like a wonderful thing, as everyone is moving to a less costly, more convenient service that provides the user with many choices and options. It does not take a lot of special equipment to get started. All you need is a broadband Internet connection.

For us lay persons, that means a high-speed Internet connection. This would include a cable modem or a high-speed service such as DSL or a local area network. It just does not work on a dial-up modem. You will also need either a personal computer, or a special adapter or special phone equipped for VoIP.

The beauty of VoIP is that the computer does not care how far away you are from other computers. Thus, many VoIP providers offer a service highly desirable to the public — free long distance service. My grandchildren probably will not remember a time when phone companies actually charged for long distance services.

There are some other advantages of using VoIP. For example, some providers may offer features and services that are not available with a traditional phone. In some cases, the services might be available but only for an additional fee. In many cases, people are able to eliminate the use and cost of a traditional phone line.

The beauty of VoIP is that the computer does not care how far away you are from other computers.

Like everything in life, there also are some disadvantages to using VoIP that must be considered. What is generally less well known is that there are some significant risks associated with the conversion. For example, some VoIP services do not work during a power outage. Further, the VoIP provider might not offer a backup power option. As a result, one might be without phone service at a time when it is most needed. To complicate matters further, some VoIP services do not connect directly with 911 emergency services, making access to adequate emergency response less timely or perhaps less reliable. The Federal Communication Commission has issued rules related to provision of 911 service.[2] Before you commit to using a service, be sure it meets your needs with regard to emergency services access.

Another disadvantage for first responders is that a 911 call received through a traditional telephone line can be tracked to determine where the call originated. With VoIP, it may not give first responders any location information. Directory assistance is another area where service offerings should be explored in advance. Perhaps the most significant risk is associated with Internet security. Most people don't realize that it is just as easy for a hacker to capture a conversation as it is to intercept an email.

Any time there is risk associated with a human activity, it presents both opportunities and challenges for the insurance industry. In this case, some of the risks seem to be closer to inconveniences than catastrophes. However, the risks associated with Internet security could prove to be catastrophic in nature. This presents both challenges and opportunities for insurers. Insurers should evaluate policy language to be sure that exposures to loss from hackers accessing phone conversations are properly addressed. On the opportunity side, insurers who do identify this risk of loss may be able to offer appropriate levels of coverage for the exposure and generate premium income for the risk transfer.

Those interested in additional information about VoIP and its potential impact on the insurance industry are encouraged to read a white paper drafted by **Harry E. Emerson III** titled "Internet-Based Telephony: An Anticipated Producer of Major Losses in Cyberspace — A New Frontier for Insurance Carriers." It can be accessed at http://www.ironpipe.net/Assets/VoIPInsuranceReportByEmersonDevelopment.pdf. ■

Endnotes

(1) Federal Communication Commission web site. http://www.fcc.gov/voip/. Accessed on Feb. 16, 2011.

(2) Federal Communication Commission web site. http://www.fcc.gov/guides/voip-and-911-service. Accessed on June 24, 2011.

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