A Proposal to
Modernize Insurance Agent Licensing

an Addendum to

Information Technology
and
Insurance Agent Licensing

Stewart Economics, Inc.
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Introduction

Earlier this year, we published a report entitled *Information Technology and Insurance Agent Licensing*.

The report described recent advances in information technology that are changing insurance in a big way, especially at the point of contact between the insurance business and the customer. The report also described the main kind of government regulation of that point of contact – the state's licensing of insurance agents.

While not venturing to predict the exact path of change as insurance picks up new technology, the report did find a natural path for the insurance business to follow. That path is to reduce its running costs, to become more competitive and to experience a breaking down of institutional and geographic boundaries that confine and protect it.

The report concluded that such a natural path of change will result in a fundamental conflict with the rules of agent licensing. The report noted that when, in the past, important new technologies have been held back by regulatory rules, in insurance and in other regulated fields, the technology has tended eventually to prevail. The report concluded that such a collision between technology and agent licensing is imminent and that it can and should be avoided.

But the report did not set out any recommendations about how to avoid the collision. Since the report's release, we have received many inquiries about what our recommendations are. This Addendum contains our recommendations.

The first part of this Addendum is a summary of the analysis and conclusions of *Information Technology and Insurance Agent Licensing*. That summary overlaps with

the Executive Summary of the earlier report. But here it is less concerned with the historical tale and economic context and more with getting to the point of the recommendations. A reader who is familiar with the earlier report could well skip it and go straight to the proposal. The proposal section of this Addendum takes up the objectives of agent licensing, the current activities of the NAIC to update the licensing process, our recommendations regarding changes and, finally, the text of suggested legislation.

Summary of
Information Technology and Insurance Agent Licensing

Rapid advances in information technology are changing all kinds of business. Digitization has made it possible to process and communicate information faster, cheaper and more easily and reliably than ever before. Businesses are using information technology to improve quality, to lower costs and to design new products and services. It is not just producer or seller technology, of which buyers are passive beneficiaries. It also gives buyers new tools for demanding more from those who would sell to them, for continuously comparing their offerings and prices, and for pitting sellers against one another.

The insurance business is being changed by information technology too, and in much the same ways as other businesses. Intelligent participants in the insurance business will want to take advantage of the changes.

Insurance and Technology

Insurance is no stranger to technological change. Over the years, the business has used improvements in information technology to lower its own expenses. And as other technologies brought better health, longer life, fewer fires and safer factories and highways, insurance brought cost savings to the public with profit to itself.

In recent years, information technology has lowered the capital costs of insurance through risk management and the unbundling of insurance products. Over and over again, consumers have benefited. Competitors who rode the changes gained over those who resisted or ignored them.

Insurance Regulation

The main way technology affects the competitive market is by giving some competitors an edge over others. Regulation sets many of the rules of competition. Hence regulation plays a role, sometimes an important role, in determining how quickly and under whose auspices the cost and service advantages from new technology get to the public.

With technology moving so quickly, the shifts in the competitive pecking order will tend to come quickly too. But even where generally beneficial, rapid competitive shifts are disruptive to any business. That is where regulation comes in. Regulation can hold the changes back for a while.

Technology and Regulation

Any kind of regulation – including state regulation of insurance – tends to guard its jurisdiction over the regulated activity and to side with regulated constituents who feel threatened by change. At times in the past, regulation (including insurance regulation) has resisted competitive innovations made possible by information technology. But where technology lowered costs or otherwise served both sellers and buyers, it was not held back for long.

It is in the nature of advances in information technology to leap over borders of geography and boundaries of profession. It is in the nature of regulation to respect and enforce those borders and boundaries and to try to make them permanent. The changes based on recent advances in information technology will inevitably run up against regulation of many kinds. The most exposed aspect of insurance regulation is the licensing of insurance agents.

Insurance Agents

However important they are today, insurance agents were absolutely indispensable when the insurance business was growing up in this country. Back then the country was large and sparsely settled. Communication was slow, expensive and unreliable. Insurance companies doing business beyond their home offices had to delegate a lot of authority to their local agents. The agent was in charge of much of the underwriting, pricing, market strategy and administrative work that now falls to an insurance company.

Yet the early agent, vital as he was, was not a business in the modern sense. In the tiny clusters of people scattered across the empty land of early 19th century America, there was not much insurance to be done. Being an agent was largely a sideline for a farmer or storekeeper. An insurance agency in those days was not an organization. It was one person.

Early Agent Licensing

So when the state wanted to get hold of the insurance business for some reason, the state reached out for that person -- the sole practitioner insurance agent.

The first reason for reaching out was tax collection. Starting in the first half of the nineteenth century, states got revenue from insurance by taxing premiums. The big insurance companies were back on the East Coast. For a tax collector that could be too far away. So the states looked to the local agents for the out-of-state insurers. Licensing those agents gave the states the ability to keep track of them and to revoke the licenses if the agents did not collect the tax money and pay it over.

A New Purpose of Licensing

Fifty years later, in the late nineteenth century and early twentieth, the states looked to the local agents for even more leverage over the insurance business – to restrict competition.

Insolvent or financially shaky insurance companies undermined a community's ability to rebuild after a fire and a family's ability to continue after the death of the wage earner. The states decided that price cutting and commission bidding were to blame. So they set out to shut those practices down.

For that the states needed to reach all the agents and all the companies. Again the agents were the one face of insurance present in every state. So the states extended licensure from the representatives of out-of-state companies to those of all the companies. The idea was that a license once granted could be revoked – for cheating on the fixed prices and commissions.

Yet Later Reasons for Licensing

The first reason for licensing (tax collection) was solely a public purpose, and the second (solvency via limited competition) was at least partly so. Both called for using licensure to control agents, but neither called for restricting eligibility to become one.

As time passed the objectives of licensing became more internal to the insurance business, and the states began to restrict who could enter the field. Starting in the 1930s, the states began to use licensure to police professional qualifications. Then expressly protectionist objectives came into view. Eligibility was tightened so as to

shut competitors out, whether they were defined as agents of an unwelcome type or agents from another state or representatives of a non-insurance institution.

The Unchanged Mechanics of Licensure

Through all those changes in purpose, the mechanical requirements remained as they had always been – personal and local. An agent's license was for the individual to qualify for and to obtain. Even where the agency as an organization needed a license, it got one via the individuals in it.

Licensing remained local, in the sense that it was administered by each state for itself, with no deference to what may have been done in another. That does not matter where an agent or agency does business in only one state, and such was the business reality when licensing began. But it is not the reality now, except insofar as regulation makes it so. So state licensing today means a separate license, and licensing process, for every individual agent from every state in which the agent has a customer or helps cover a risk. Localism now means repetition. Repetition means burden, especially as markets open up.

The Collision of Technology and Licensing

Obviously no one can predict exactly how information technology will affect insurance in the future. But it is pretty sure to lead to cutting costs, to enlarging markets, to blurring institutional and functional distinctions and to crossing jurisdictional and geographic lines.

Those tendencies of technology will bring it quickly into conflict with the local, personal, repetitive and protectionist aspects of agent licensing. With all the potential of information technology to cut costs and improve service, it would be unfortunate

and embarrassing for insurance regulation to find itself, more by inattention than anything else, in a posture of opposition to the competitive use of that technology.

That much is clear just from examining the normal trajectory of technological change in competitive businesses and the rather peculiar history of insurance agent licensing. The situation becomes even more challenging, and the stakes even higher, once we consider some other factors present in this situation.

A Possible Increase in Consumer Influence

Insurance has dealt with technological advance many times in the past. Often a new technology has let the industry do its work in a more efficient way. As the more efficient have competed the less efficient out of the market, consumers have reaped some of the benefit. But the benefits have had to await the competitive outcome, and the sell side of the market has been in control throughout.

That may not be true of this episode, as the recent advances in information technology work their way into market practice. The early evidence from other businesses is that sophisticated buyers can use new technology to drive much of the change, forcing sellers into direct competition on terms the buyers lay down.

In insurance too, the potential for such a power shift is there. Among the artifacts of the current technological era, the Internet and its associated software by themselves offer the potential for consumers – personal as well as commercial – to dictate the terms and degree of price competition. And there are others. If the economic rewards are big enough, the changes will work around regulatory barriers. How easily is indicated by the rapid substitution of risk management, financial contracts and offshore entities in place of regulated insurance in commercial markets.

Obstruction Does Not Help

Market intermediaries, including insurance agents, bring buyers and sellers together. Bringing buyers and sellers together is a process of gathering, processing and communicating information. Anything that changes the value of that information or the cost of handling it opens the way for competition. It favors those quick to move. It puts all at risk.

Sometimes regulation can retard change or hold competitors at bay. Such a tactic feels good to the protected, but it almost never works for long. When the legal barriers come down, the hitherto protected segment is in a particularly bad position. It is most apt to have sunk costs in outdated technology. It is most exposed to the price-cutting that accompanies the entry of new suppliers. And the protected segment is likely to have become dependent on the existence of a pervasive regulatory system, whereas the new field will likely have opened with no regulation at all.

The Difficulty of Modernizing Agent Licensing

The analytical case for reforming agent licensing so as to accommodate new information technology may be compelling. But that does not mean it will be easy. Four more facts about licensing suggest it will be especially difficult.

One, agent licensing is not just old. It is older than any other part of the situation. It is older than any form of instantaneous communication. It is older than any form of rapid transportation. It is older than the interstate insurance business. It is older than any other part of insurance regulation. It is older than any of the devices for interstate cooperation that now exist in insurance regulation.

Two, agent licensing is based on assumptions that are the antithesis of those of information technology. The classical agency system, and agent licensing, came into existence largely because there was no communication of data and not even any accepted way to use data to keep track of an insurance business. Our present beliefs about information are almost the exact opposite – data can be manipulated endlessly at negligible cost, used to measure and control nearly anything and communicated anywhere in no time at all. With so little common ground, calls to accommodate can sound like denials of the right to exist.

Three, being out of date can be an advantage from some points of view. The very awkwardness and anachronism of agent licensing have become part of its appeal. A market entry procedure that is repetitive and burdensome can be quite appealing to business interests threatened by new competitors.

Four, and a related point, the very intricacy of agent licensing has become part of its charm. Not every attachment to an outmoded way of doing things is venal or stupid. It can just as well be aesthetic and innocent. Complexity and anachronism are appealing, most of all to those who have mastered them. The commissioners have invested nearly two centuries in making agent licensing work somewhat. That is no mean accomplishment. They might be forgiven a reaction to sweeping reform akin to that of an antique car buff to a proposal to get rattletraps off the road.

All the foregoing suggests that modernizing agent licensing is going to be even more difficult than it appears, and it appears difficult enough.

A Proposal to Modernize Insurance Agent Licensing

Deciding that agent licensing needs to be modernized still leaves a lot to do. It is more than a bill drafting exercise. We need to identify the essential issues, and we need to think through the purpose of licensing in today's market, particularly as it assimilates advances in information technology. This section attempts to do those things and to reconcile our views with the NAIC's ongoing work in the field. Only then can we write the necessary legislation.

The Need for Balance

To say agent licensing is badly out of date is not to say it is all bad. To say information technology is very promising is not to say its effects will be all good. We will do well not to get carried away in any direction.

The key to balanced reform of agent licensing is to treat it as yet another modernization of state regulation of insurance. It is one such step in a long succession. State regulation of the interstate and international insurance business is, on the face of it, not an arrangement you would expect. It is understandable only historically. But in most situations it works. Despite the occasional exasperation, state and federal policymakers have been well advised not to sweep it away.

There has been much change in the business of insurance and its regulation during the century and a half since agent licensing began. When it began, there were no statutory financials, no uniform laws, no convention examinations. Even the formative meeting of the National Convention of Insurance Commissioners was a decade or so ahead.

Since then state regulation has adapted to changes in the insurance business – and particularly to its increasingly interstate character – in many imaginative ways.[1]

The Public Goal of Licensing Today

Agent licensing was created to give the nineteenth century state some leverage over the nineteenth century insurance business for nineteenth century reasons. That opens the possibility that licensing might be found irrelevant to today's objectives, and hence no longer necessary.

The dominant reasons for licensure changed in the early twentieth century to emphasize professionalism and protection from outside competition. That opens the possibility that licensing might be found to be an instance of regulatory capture, and hence no longer desirable.

Were licensing now either unnecessary or undesirable, we could simply do away with it. The case for licensing agents at all may indeed be less compelling than it was a hundred years ago. And its burdens are worse now and are sure to get a lot worse shortly. But licensing still serves good purposes. We just need to be clear about what agent licensing does for the public today.

We believe the public goal now is to promote a safe and stable agency function. Safety relates to individual transactions, particularly to those that go awry. It means assuring that there will be resources to make up for an agent's compensable mistakes

[1] Those ways include financial condition reporting on a standard Annual Statement (c. 1871), cooperative on-site Convention Examinations of multi-state companies (c. 1910), uniform Statutory Accounting rules (c. 1949), a multitude of uniform laws and the strengthened coordinating function of the NAIC's Support & Services Office.

and misbehavior. Stability relates to the long-term behavior of the whole system, to its self-policing and self-stabilizing mechanisms.

Safety and stability are enough for the state to worry about. The competitive market will attend to efficiency by itself.

So the affirmative objects of the reform of licensing are a safe and stable agency function. The negative object of reform is the one the earlier report focused on – to get agent licensing out of the way of the insurance industry's use of information technology to reduce costs and improve service.

Legislation to achieving the negative object and affirmative object together will have to deal with two big topics – the burden of licensing (from being personal and locally repetitive) and the use of licensing to limit competition, which is tied into the burden problem today but is also a problem in its own right. The next sections take up those questions. They include a discussion of the key technique for securing our goals, which is to deal with organizations rather than individuals.

Licensing as Burden and as Protectionism

To deal with licensing as a burden, we need to recall that the current problems come from two of licensing's oldest features. It has remained local and personal long after the disappearance of the business facts and public policies that made it that way. Agents are licensed as individuals. By contrast, at the insurance compan*y* level the states license the corporation rather than the individuals in it.

Already a burden on interstate business today, those two characteristics of licensing are sure to become more of a problem as technology leads to the opening up of geographical and functional markets.

To deal with licensing as protectionism, we need to analyze what the state gets from licensing. It got in the past and gets now three kinds of power over a vital part of the insurance business – the point of contact with the public. First, the state gets the power to decide who can enter that part of the business. Second, it gets the power to keep track who is in the business. Third, the state gets the power to punish the people it has let enter that part of the business by throwing them out of it.[2]

Of those kinds of state power, the one that lends itself to protectionism is the same one that generates conflict with technology. It is the first – the power over entry. The restrictive and protectionist aspects of the system – personal licensure, repetitive licensing in each state, the residency requirements – are all tied up in the power over entry. By contrast, the powers to track and penalize agents do not impair competition and should not hamper the competitive use of new technology. Tracking and penalizing are the key powers when it comes to chasing really bad individuals out of the insurance business. They would also be the most useful powers for insurance departments to use to prod organizations – companies and agencies – to assume more responsibility for the individuals they employ.

Before taking up the legislation to achieve those goals, we should look at what the NAIC is doing, so that the existing and recommended efforts can fit and complement each other.

Current Activities of the NAIC

The National Association of Insurance Commissioners (NAIC) has recognized that agent licensing is out of step with today's insurance business. The fact that

[2] Those three aspects of the leverage conferred by licensing are discussed in Part Two of *Information Technology and Insurance Agent Licensing*.

insurance regulation is increasingly interstate (based in part on the number of producers transacting business in more than one state) was behind the development of the Producer Information Network and the Producer Database.[3] The challenges to regulation from advances in technology (particularly from the use of the Internet for insurance transactions) are prompting the NAIC also to re-examine its model licensing laws.

The NAIC has identified the agent licensing problem as "the inefficiencies in the licensing process created by the different rules, regulations and procedures in place in each state," noting that as the business "crosses more jurisdictional boundaries, insurers and producers are impacted by less consistency among state insurance departments."[4] The NAIC measures the cost of the inefficiencies in terms of the transaction costs to industry and government, a cost estimated to be some fraction of the $350 million spent by the industry (not including state fees) and the $30-60 million spent by the state insurance departments on the process.[5]

Anyone's prescription for dealing with a problem depends on how that person sees the problem. Anyone's perception of a problem will be influenced by that person's experience with problems in the past. The NAIC has 130 years of experience in dealing with insurance regulatory problems of repetition and unevenness as many states deal

[3] Both are now organized under a new affiliate, the Insurance Regulatory Insurance Network (IRIN).

[4] Section I-B, PIN Business Imperative, PIN/SERFF Proof-of-Concept Report, National Association of Insurance Commissioners, January 8, 1996.

[5] White Paper on Regulatory Re-Engineering of Commercial Lines Insurance, National Association of Insurance Commissioners, version dated 3/15/98.

with a national business.[6] We should not be surprised that the NAIC's projects are inclined toward what the NAIC has dealt with in the past.

The Producer Information Network and the Producer Database are designed to deal with the problems as the NAIC sees them. The objectives of those projects are uniform standards and a streamlined licensing process. The specifications stipulate that the states are to retain control and that neither project is to replace state licensing systems.[7]

The same objectives animate the NAIC's review of the Agent and Broker Licensing Model Act and the Single License Procedure Model Act, which is being undertaken specifically to consider changes in light of a broadening, technology-driven, insurance marketplace. Guiding the deliberations are the principles of uniformity and reciprocity.[8]

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[6] The opening speech at the first gathering of state insurance regulators made the point. New York Superintendent George W. Miller, in his address of May 24, 1871, set out suggested areas of cooperative activity, especially in legislation. After listing specifics, his final suggestion was to consider: "How to bring about, generally, the broadest uniformity, simplicity, security and reciprocity."

[7] The Producer Database (PDB) is a common database that will eventually contain all the states' producer information. As of the first quarter 1998, fourteen states were reporting data to the PDB. The PDB will make it possible to automatically notify all states where a producer is licensed any state's regulatory action against that producer.

[8] There is an additional objective – state revenue and private business revenue. See Section I-B, PIN Business Imperative, PIN/SERFF Proof-of-Concept Report, National Association of Insurance Commissioners, January 8, 1996. Money comes to the states both from direct licensing fees (as from the very beginning of licensure) and from fees paid by the companies that offer the courses of instruction needed to prepare applicants for licensing exams and to enable licensed agents to satisfy continuing education requirements. To the degree that the combined interests of the states and the educational companies pose a theoretical (or practical political) barrier to reform of licensing – whether our proposal for organizational licensing or the various proposals for reciprocity – a successful reform may have to include replacement of their revenues, or at least the states' revenues, in one way or another.

Reciprocity generally means that a state will not impose its own licensing requirements but will automatically license a non-resident producer who is licensed in good standing in his home state. Although reciprocity would substantially reduce the mechanical burdens of licensure, it directly conflicts with the NAIC's policy of state control and may even conflict with some state constitutions. In terms of our analysis of licensing as an undesirable restraint on information technology, the big shortcoming of reciprocity as a modernization technique (and of uniformity as well) is that neither of them alters the personal nature of agent licensing.

When we criticize the NAIC for turning to uniformity and reciprocity as answers, we are mindful that those two prescriptions have worked over and over during the century and a half that the NAIC and the individual states have coped with the problem of state regulation of an interstate business. They just won't work on this problem.

We agree with the NAIC that the agent licensing system needs modernizing, but we see the main problem not as a lack of uniformity but as redundancy and needless personal burdens. We would count the cost of the system's shortcomings not only in the direct transaction costs of compliance but in the far larger indirect or opportunity costs of being held back from making aggressive use of the capabilities of new information technology.

We do not doubt, however, that the problems the NAIC sees are real enough. It is quite likely that both the problems they see and the problems we see are entirely real, and that both should be addressed. The NAIC's solution is standardization and automation of the process. Ours is simplification and the elimination of redundancy and protectionism. They are different approaches to different problems. Nothing in the

NAIC's analysis should deter pursuit of our kind of reform, and nothing in our analysis militates against theirs.

The First Goal of Legislation – Less Burden

In designing legislation to address the problems we foresee, the crucial question is: In what circumstances to dispense with personal licensure? The general answer is: When there is a business organization willing to take responsibility for the person.

That works out easily where a company will step up. One successful strategy for intermediaries in recent years has been to simplify agency functions, cut costs, integrate more closely with companies and ride down the declining curve of overhead and distribution costs. In that relation, the company becomes a valuable resource for licensing reform. It should be willing to commit to stand fully behind the agent's acts on its behalf, without recourse to the exceptions that the law sometimes gives.[9] The organizations most likely to avail themselves of such an exemption from licensure would be direct response companies (for their employed telephone representatives), exclusive agency companies (for their agents) and independent agency companies having close relations with their agents.

In those situations, the insurance departments and any wronged customers would have direct financial recourse against the company or companies standing behind a misbehaving agent, as well as the recourse against the agent and agency which they have under present law. Since the exemption would only be available to the agents of

[9] The law of agency generally makes a principal responsible for the acts of his agent, but only within the scope of the agent's actual or apparent authority. It is a matter of state common law, and the law varies in subtle ways. Those fine distinctions can be of real consequence to a customer to whom the agent made representations beyond his authority or even contrary to instructions. A broader commitment would simplify and clarify the company's obligation and reduce the uncertainty to consumers. In general, an employer is more strictly bound by his employees.

licensed companies, and since financial strength is the key criterion for licensing a company, the state would already, in effect, have passed on the company's ability to give such commitments. Knowing it could be held responsible, such a company would have yet another incentive to stay on top of its agents' treatment of customers and to foster their professional development.

What about agents without full company backing? The category is varied. It includes very large organizations that have pursued the strategy of deepening the intermediary's role to justify his compensation. In it are the "alphabet brokers", which hold many agency licenses corporately and individually on their staffs. Those are the firms which pioneered the risk management movement on behalf of their large corporate clients. They are unlikely to want to solicit, and insurance companies are unlikely to want to provide, the company commitments needed for license exemption.

Where those large organizations will commit to stand unconditionally behind their employees and sub-agents, those individuals should be treated the same as individuals with the same backing from an insurance company. The individuals would be exempt from licensure and would be registered instead. They would, of course, be subject to the same state discipline as individuals exempted from licensure by virtue of insurance company support. Since even the largest agencies are not capital-intensive institutions the way insurance companies are, and are not subject to continuing financial audit and regulation by the commissioners, the states could require financial reinforcement for their commitments, in the form of surety bonds, liability insurance policies, bank letters of credit or other financial guarantees.

The category of agencies without insurance company backing would also include far smaller organizations, right down to the incorporated one-person shop. They too would have the opportunity to be exempt from personal licensure if they were

prepared to post the required guarantee. Their decision would be an economic trade-off – of the costs of the guarantee against the costs of personal licensure, a trade-off which would most likely turn on the number of employees and sub-agents in the agency and the geographic range of its operations.

Requiring a financial guarantee is aimed precisely at opening up competitive opportunities for firms of all sizes. Rather than set up administrative barriers for smaller firms, financial guarantees would allow the market to sort out which agencies could operate without personal licensing.

For individuals without company or agency backing, the present form of state licensing would, of course, remain available.

The Second Goal of Legislation – Less Barrier

If exemption from licensure meant total freedom from state control, then the exemption would also accomplish the removal of licensing barriers to entry. It is indeed tempting to leave with the companies and agencies giving commitments the sole responsibility for the agents they have committed to. That would create a two-tier system, with the state regulating the companies and agencies that gave commitments and those companies and agencies in turn regulating the individual agents.[10]

Although it seems logical for the system of licensure to migrate in that direction, it is very far from where the system began and some distance from where it is today. So we would recommend an intermediate status for the individual producers in

[10] Some European countries have such two-tier systems with regard to insurance companies and their agents. They include Belgium, Germany, Spain, Switzerland and the United Kingdom.

companies and agencies that stand legally behind them. We call that status "registration".[11]

Registration would be a listing only, involving no qualification test. Hence it could not be used to restrict entry the way licensing can. The complication and cost of simple registration are coming down, thanks once again to advances in information technology. Companies can make routine filings with many states easily, and the NAIC's Producer Database project offers the prospect of a single central filing.

Registration would enable the state to keep track of which agents were doing business where. Disciplinary removal of an agent from the registration rolls could have the same effect as license revocation. It would enable the states to deal with the occasional recidivist and really bad actor.[12]

The next sections of this Addendum set out the proposed legislation in outline and then in full text.

Outline of Recommended Legislation

Our specific recommendation is that each state enact a law that would accomplish the following:

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[11] The first version of our proposed legislation, beginning on page 24, which permits exemption from personal licensure where an insurance company stands behind its agents, does not use the term "registration" but instead utilizes the familiar "appointment". In practice, appointment and registration would be equivalent.

[12] Under our proposal, an individual agent who was exempt from licensure because of company or agency backing would be subject to the following regulatory sanctions for his misconduct: cancellation of his registration, personal fines (in states with that power), prohibition from engaging in agency work in the future and, as an indirect but probably forceful sanction, fines, license action and liability awards against the insurance companies on whose behalf he acted.

A. Insurance Company Commitment

Where all of the insurance companies an individual agent represents in a state are licensed there and commit to stand behind his acts and knowledge, then that individual would not need to be licensed as an agent in that state.[13]

B. Agency Commitment

As for insurance companies, above, but with a requirement of further security by liability or surety policy, letter of credit or other financial guarantee.

C. General Regulatory Provisions

1. Where an individual is exempted from licensure due to commitment by a company or agency, then the committing organization would have to register that individual with the insurance department of every state in which the individual transacts insurance.

2. The insurance department would have the same authority as it has today to discipline companies, agencies and individual agents. The penalties of suspension and revocation of an individual's appointment or registration would have the same legal effect as those penalties have now when imposed on a licensee.

[13] The commitment would be required only from companies the agent represented in the voluntary market. Under the residual market arrangements (such as automobile insurance assigned risk plans) in some states, an agent and company that do not otherwise do business with each other can be placed in an involuntary relationship with respect to a single risk. Our proposal does not contemplate that any company (whether the involuntary market company or the agent's voluntary market company or companies) commit to back the agent under those circumstances in order for the agent to be exempt from licensing. Assigned risk and other residual market arrangements vary considerably from state to state. Any state that considered this situation to require special treatment could make special provision for it. Any such provision would more appropriately be part of the residual market law than of the agent licensing law.

3. Where licensure is required for an agent, no residence or legal domicile requirement would be imposed.

4. Where two states both have adopted licensing laws with the foregoing provisions, their retaliatory laws would not apply as between them on agent licensing matters.

Those legislative points can be carried out within the context of the existing agent licensing statutes by a relatively simple amendment. We offer two versions of a statutory text to show how it might be drafted. The first version is legislation that would extend the exemption only where an insurance company gave unconditional backing to the individual. The second version would extend the exemption where either an insurance company or an insurance intermediary gave an unconditional, secured backing to the individual.[14]

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[14] Whichever version of the proposed statute were chosen for drafting mechanics, it would have to be fitted into the statutory framework and language of each state. They vary widely from state to state. In addition to conforming to each state's statutory format, the legislation would need to vary depending on (i) whether the enacting state had resident agent and countersignature requirements, and (ii) the breadth of the enacting state's retaliatory law.

Proposed Legislation

Exemption with an Insurance Company Commitment

This version of our recommended legislation, exempting from licensing only persons with an insurance company commitment, would add to the state's insurance agent and broker licensing law (the "Act) the following titled new Chapter.

Chapter [ ]. Exemption from Licensing of Persons Subject to Commitment by Licensed Insurers; Nonretaliation; Abolition of Countersignature and Related Laws

Section 1. Exemptions from License Requirement.

1. No license under this Act shall be required of an individual appointed as an agent of an insurer licensed[15] to transact insurance in this state if the written appointment states the unconditional commitment of the insurer to be bound by and liable for the actions, representations and knowledge of the individual made or acquired in the course of the insurer's business. An individual is exempt from license requirements under this Section only if the individual holds such an appointment from all insurers for whom the individual engages in activities for which a license would otherwise be required.

Section 2. Conditions and Requirements of Exemptions from License Requirement.

2. The exemption provided by Section 1 from license requirements under this Act is subject to all of the following conditions and requirements.

[15] "Licensed" as applied to an insurer means legally approved by the state regulatory authority to solicit, negotiate, sell, issue and administer insurance within the state and includes, depending on the terminology used in the state, an "admitted" insurer or an insurer holding a "certificate of authority". It does not include insurers approved only for surplus or excess line writings or reinsurers writing on an unauthorized basis.

A. Appointments made pursuant to Section 1 shall be in writing and in a form prescribed by the Commissioner[16] and filed with the Commissioner, accompanied by the fee otherwise specified in this Act for such filing or, if no such fee is specified, then the amount of the fee for any license which would be required in the absence of the exemption provided by this Chapter. If the person appointed is an employee of an agent licensed in this State, the appointment shall identify the agency.

B. Appointments made pursuant to Section 1 shall remain in force, unless earlier terminated as provided in Section 3, until the annual date (which shall be either one year from filing or such other yearly filing date as the Commissioner may prescribe), at which time the appointments terminate unless renewed and refiled in a manner prescribed by the Commissioner.

C. The exemption from licensing resulting from appointments filed pursuant to this Chapter are limited to the lines of insurance specified in the appointments.

D. The Commissioner shall establish and maintain a registry of all persons exempt from licensing under this Chapter which shall contain the appointments filed by insurers, the name of any agency or insurer by which the person is employed, the term of appointment, and the causes and circumstances of termination of appointments. The registry shall be a public record.

Section 3. Termination of Exemption from License Requirement.

3. Appointments by insurers and the exemptions from licensing requirements of the Act resulting from them will be terminated as follows:

A. By the insurer making the appointment by filing a termination notice with the Commissioner in a form prescribed by the Commissioner. The termination shall be effective at the end of the next business day following upon receipt of the filing by the Commissioner.

[16] The usual title for the chief insurance regulatory official of the state. Where appropriate, "Superintendent" or "Director" should be substituted.

B. By the Commissioner for the causes and in accord with the procedures otherwise provided in the Act for the suspension or revocation of licenses of insurance agents.

C. Automatically upon the revocation or suspension of the license of the appointing insurer to transact business in this State or of any legal determination of insolvency or hazard of the appointing insurer.

Section 4. Nonretaliation.

4. Notwithstanding any other provision of the Act, this state will not impose retaliatory burdens or requirements on persons holding insurance licenses, or engaged in the transaction of insurance but exempt from license requirements, under the laws of another state having a law substantially the same as this Chapter.

Section 5. Countersignature and Related Laws: Repeal

5. Notwithstanding any other provision of the Act or of any other laws of this State, there shall be no requirement that a licensed resident agent or broker must countersign, solicit, transact, take, accept, deliver, record or process in any manner an application, policy, contract or any other form of insurance on behalf of a nonresident agent or broker and/or authorized insurer, or share in the payment of commissions, if any, related to such business.

Exemption with an Insurance Company or Insurance Intermediary Commitment

This version of our recommended legislation, which extends the exemption from licensing to persons with a secured commitment from an insurance intermediary, differs from the prior version primarily by the addition of Section 1.B. The legislation would add to the state's insurance agent and broker licensing law (the "Act) the following titled new Chapter.

Chapter [ ]. Exemption from Licensing of Persons Subject to Commitment by Licensed Insurers or Insurance Intermediaries; Nonretaliation; Abolition of Countersignature and Related Laws

Section 1. Exemptions from License Requirement.

1.A. No license under this Act shall be required of an individual appointed as an agent of an insurer licensed to transact insurance in this state if the written appointment states the unconditional commitment of the insurer to be bound by and liable for the actions, representations and knowledge of the individual made or acquired in the course of the insurer's business. An individual is exempt from license requirements under this Section only if the individual holds such an appointment from all insurers for whom the individual engages in activities for which a license would otherwise be required.

1.B. No license under this Act shall be required of an individual to engage in activities for which a license would otherwise be required by this Act if the activities are engaged in as an employee or independent contractor of an insurance intermediary, being a person or entity licensed in this State to transact insurance on behalf of another, whether as agent or broker, and the activities are within the authority conferred by the intermediary's license and

(i) The insurance intermediary has filed with the Commissioner a written statement, called a "registration", of the employment or other engagement of the individual and of the insurance intermediary's unconditional commitment to be bound by and liable for the actions, representations and knowledge of the individual made or acquired in the course of the business of the insurance intermediary, and

(ii) The insurance intermediary has in force a surety bond, liability insurance policy, certificate of deposit or other form of financial guarantee issued by a bank, insurer, or other institution approved by the Commissioner, with the terms and in a form approved by the Commissioner, unconditionally guaranteeing the performance of the commitment described in subparagraph (i) above and the payment of any legal liabilities arising therefrom. The amount of the financial guarantee to be provided by the insurance intermediary shall be determined by the Commissioner, considering the volume of activities engaged in by the insurance intermediary to which the guarantee applies, the number of individuals employed or engaged by the insurance intermediary to which the guarantee will apply, the financial size of the business activities which are to be transacted and the probable amount of financial harms which may arise from possible misconduct by an individual employed or engaged by the insurance intermediary in the conduct of such activities. A certificate executed by the issuer of the financial guarantee provided by the insurance intermediary evidencing its issuance, amount and term shall be filed with the Commissioner as part of the registration. The financial guarantee and the certificate evidencing it shall provide that the financial guarantee may not be cancelled or terminated for any reason as to the Commissioner or members of the public having claims thereunder or insured thereby except after ten (10) days notice to the Commissioner. The financial guarantee shall provide that termination of the guarantee, whether by expiration, cancellation, rescission or otherwise, will not relieve the issuer of its obligations and liabilities to the Commissioner or the public for harms, losses or damages arising from conduct, actions or omissions occurring before the effective date of such termination.

Section 2. Conditions and Requirements of Exemptions from License Requirement.

2. An exemption provided by Section 1 from license requirements under this Act is subject to all of the following conditions and requirements.

A. Appointments and registrations made pursuant to Section 1 shall be in writing and in a form prescribed by the Commissioner

and filed with the Commissioner, accompanied by the fee otherwise specified in this Act for such filing or, if no such fee is specified, then the amount of the fee for any license which would be required in the absence of the exemption provided by this Chapter. In the case of an appointment of a person who is an employee of an agent licensed in this State, the appointment shall identify the agency.

B. Appointments and registrations made pursuant to Section 1 shall remain in force, unless earlier terminated as provided in Section 3, until the annual date (which shall be either one year from filing or such other yearly filing date as the Commissioner may prescribe), at which time the appointments and registrations terminate unless renewed and refiled in a manner prescribed by the Commissioner.

C. The exemptions from licensing resulting from appointments or registrations filed pursuant to this Chapter are limited to the lines of insurance specified in the appointments or registrations.

D. The Commissioner shall establish and maintain a registry of all persons exempt from licensing under this Chapter which shall contain the appointments filed by insurers and registrations filed by insurance intermediaries, the name of any insurance intermediary or insurer by which the person is employed, the term of appointment or registration, and the causes and circumstances of termination of appointments or registrations. The registry shall be a public record.

Section 3. Termination of Exemption from License Requirement.

3. Appointments by insurers and registrations by insurance intermediaries and the exemptions from licensing requirements of the Act resulting from them will be terminated as follows:

A. By the insurer making the appointment or the insurance intermediary making the registration by filing a termination notice with the Commissioner in a form prescribed by the Commissioner. The termination shall be effective at the end of the next business day following upon receipt of the filing by the Commissioner.

B. By the Commissioner for the causes and in accord with the procedures otherwise provided in the Act for the suspension or revocation of licenses of insurance agents.

C. Automatically upon the revocation, suspension or surrender of the license of the appointing insurer or the registering insurance intermediary to transact business in this State or of any legal determination of insolvency or hazard of the appointing insurer or registering insurance intermediary or upon the expiration of, or the receipt by the Commissioner of notice of cancellation or other termination of, the financial guarantee filed as part of a registration.

Section 4. Nonretaliation.

4. Notwithstanding any other provision of the Act, this state will not impose retaliatory burdens or requirements on persons holding insurance licenses, or engaged in the transaction of insurance but exempt from license requirements, under the laws of another state having a law substantially the same as this Chapter.

Section 5. Countersignature and Related Laws: Repeal

5. Notwithstanding any other provision of the Act or of any other laws of this State, there shall be no requirement that a licensed resident agent or broker must countersign, solicit, transact, take, accept, deliver, record or process in any manner an application, policy, contract or any other form of insurance on behalf of a nonresident agent or broker and/or authorized insurer, or share in the payment of commissions, if any, related to such business.

Authorship of the Report

Stewart Economics, Inc. is a consulting firm specializing in insurance and insurance regulation.

The authors of this report are the three principals of Stewart Economics: Richard E. Stewart, former New York Superintendent of Insurance, President of the National Association of Insurance Commissioners, General Counsel of Citibank and Chief Financial Officer of The Chubb Group of Insurance Companies; Richard S. L. Roddis, former California Insurance Commissioner, Dean of the University of Washington Law School and Chief Executive Officer of Unigard Insurance Company; and Barbara D. Stewart, former Corporate Economist for The Chubb Group.

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For additional copies, please contact:

Stewart Economics, Inc.
7600 Talbryn Way
Chapel Hill, NC 27516
919-932-9800