



STATE OF ARIZONA
DEPARTMENT OF INSURANCE

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CHARLES R. COHEN
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TO: Interested Parties

FROM: Charles R. Cohen
Director of Insurance

DATE: June 21, 2001

RE: **Product Regulation Reform**

Regulation of insurance products is part of the core consumer protection activities of the Department of Insurance (DOI). By this, I mean the regulation of rates and rating rules, policy related forms, and advertising. Certain classes of insurance consumers are highly dependent upon the DOI to assure that insurance products are legally compliant, appropriate and fair. We are committed to doing the best job we can to provide regulatory protection for those consumers. To be effective in this area, we must also be efficient. Regulatory resources are finite, and must be intelligently expended.

At the same time, fostering a robust marketplace for insurance products is highly beneficial to insurance consumers. We must strive to create an environment in our state where sound insurers are naturally encouraged to compete vigorously but fairly to provide needed products and quality service. Inefficient regulation can obstruct legitimate competition and work against the best interests of consumers. The convergence of the financial services industries, the development of global markets, and the impact of information technologies have greatly intensified the need for highly efficient regulation of all financial products and services, as well as the negative ramifications of inefficiency.

Over the past months, I have been working with my staff to identify ways in which we can streamline our regulation of insurance products. Our goal is to achieve efficiency improvements that both promote competition amongst insurers and enhance regulatory protection for those consumers that rely upon it. To a great extent, we have been guided by the Speed to Market initiative of the National Association of Insurance Commissioners. In particular, we have embraced the guidelines developed by the Improvements to State Based Systems Working Group (IS3), of which I am a member. Applied to our circumstances, they result in refinements in the following areas:

- Updates to statutorily authorized exemptions from rate, form and advertising filing requirements

- Adoption of standardized transmittal forms for rate and form filings
- Development of Review Standards Checklists for many kinds of rate and form filings
- Development of a standardized process for the filing, review and approval/disapproval of rate and form filings
- Implementation of the System for Electronic Rate and Form Filing (SERFF)

FILING EXEMPTIONS

Property and Casualty

Since 1980, Arizona has had an open competition rate regulation system for property and casualty rates, except for workers' compensation and title insurance rates. Open competition rates must be filed within 30 days after their first use in the state. A.R.S. Section 20-385. Policy forms related to open competition rates must be filed at least 30 days prior to their first use in the state, and are deemed approved if not disapproved within that time. A.R.S. Section 20-398.

Under the open competition law, the Director has the authority to issue orders exempting rates and forms from their respective filing requirements if the filings are not desirable or necessary for the protection of the public. A.R.S. Sections 20-385.F. and 20-398.B. The authority to exempt form filings has always been a feature of the open competition law. The authority to exempt rate filings was added in 2000. Consequently, we will be updating our exemption order to revise the exemptions in light of current market conditions, and to add appropriate rate filing exemptions as well. Again, the point of these exemptions is to assure that our finite regulatory resources are applied to work which benefits consumers in genuine need of regulatory protection.

Notably, we are proposing to add an administrative rate and form filing exemption for products sold to "Exempt Commercial Policyholders". These are large, sophisticated commercial insurance buyers who do not require, or materially benefit from, the protection provided by DOI review of the rates and policy forms issued to them. They are policyholders able to negotiate the terms of insurance products with insurers at arm's length, and that choose to do so. Arizona already has some degree of rate and form filing exemption for large commercial buyers. This is the "industrial insured" statute, A.R.S. Section 20-400.10. The proposed administrative exemption for ECPs is in no way inconsistent with this existing statutory exemption, but does allow additional commercial buyers to qualify under the Director's administrative exemption authority.

In conjunction with the update of these statutorily authorized exemptions, we are consolidating the various orders we are authorized to issue to maintain the proper balance of regulatory and market forces in the property and casualty markets in this state. These include exemptions from the commercial lines non-cancellation restrictions (A.R.S. Section 20-1671), the determination of markets with insufficient

price competition (A.R.S Sections 20-383.B and 20-385.G.), and recognized surplus lines (A.R.S. Section 20-409). Heretofore, these orders have been considered separately and at various times. By consolidating them into one proceeding and one order, we anticipate that we will review and update them together as appropriate on a regular basis to assure that our regulation of the property and casualty markets maintains the balance that best serves the consumers in this state.

Life and Health

Most policy forms for life and health (other than managed care) insurance products in Arizona are subject to a "file and use" system. A.R.S. Section 20-1110. The forms must be filed at least 30 days prior to their first use, and are deemed approved if not disapproved within that time. Prior to 2000, life and health advertising was subject to a prior approval system. However, in 2000 the Arizona legislature eliminated the prior approval requirements, and substituted a system requiring only that the ads be filed with the DOI at the time of first use in the state. The Director has the authority to exempt life and health policy forms and advertising from their respective filing requirements if the filing and approval requirements are not desirable or necessary for the protection of the public.

In November 2000, I issued an order exempting certain life and health advertising from the filing and approval requirements. In addition, A.A.C.R20-6-218 exempts certain life and health policy forms from filing and approval requirements. As part of our streamlining in this area, we are consolidating the advertising filing exemptions and the policy form filing exemptions into one order. At this time, we do not believe we need to revise the exemptions relating to advertising. However, in order to achieve consistency with rate filing requirements under A.A.C. R20-6-607, the proposed order relating to policy forms would eliminate filing exemptions currently provided by the rule for certain individual disability policies. We intend to repeal the rule, and expect that to be accomplished around the time the order takes effect. We believe it is preferable to administer these exemptions through statutorily authorized orders so they can be adjusted as needed to briskly react to market conditions.

We are proposing a notable addition to our exemptions for ordinary life insurance policy forms and annuity contracts. This would exempt an ordinary life insurance policy form or annuity contract form from the requirement that it be filed at least 30 days prior to first use in the state, and would instead require that it be filed at the time of first use, if certain conditions apply. The essence of these conditions is that the same form has already been approved in the domiciliary and commercially significant jurisdictions where the applicable law provided an adequate standard and process for disapproval of the form prior to its use. In these cases, Arizona would of course retain its authority to disapprove the form. However, we are exempting it from the requirement of filing here prior to use under conditions that indicate our consumers are better served by allowing immediate entry of the product into our market.

TRANSMITTAL FORMS AND REVIEW STANDARDS CHECKLISTS

In order to facilitate the filing and review process for those rates and policy forms which are required to be filed with the DOI, consistent with the guidelines developed by IS3, we are adopting standard transmittal forms and have developed review standards checklists for filings relating to the major kinds of products.

We are adopting one transmittal form for property and casualty filings and one for life and health filings. The property and casualty transmittal form is the standard form adopted by IS3 for use by all states and for SERFF filings. The life and health transmittal form is our own form. However, we anticipate adopting a standard life and health transmittal form when one is developed.

Each review standards checklist sets forth in spread sheet format a description of each legal requirement applicable to the form, the legal authority for each requirement, pertinent commentary, and includes a space for the filer to identify precisely where in the form the element relating to those requirements can be found. We have already commenced using the review standards checklists in our analysis of rate and form filings relating to the following products:

Property and Casualty

- Boiler & Machinery
- Commercial Fire
- Commercial Multi-Peril
- Credit
- Crime
- Crop/Hail
- Commercial Auto
- Dwelling Fire
- Farm
- Fidelity & Surety
- General Liability
- Homeowners
- Inland Marine
- Med. Prof. Liability
- Mortgage Guaranty
- Private Passenger Auto
- Prof. Liability
- Title
- Umbrella/Excess
- Workers Compensation
- Commercial and Personal Lines Packages

Life and Health

- Individual Life and Annuity

- Individual Indemnity Health
- Medicare Supplement
- Long Term Care
- Managed Care
- Prepaid Dental Plan
- Credit Life and Disability

As part of the process of developing these checklists, we have identified and considered all the unpublished requirements (ie., “desk drawer rules”) that may have been applied to rate and form filings in the past. It is our goal to appropriately promulgate any meaningful unpublished requirements and to eliminate the use of all others. In any event, all substantive standards applicable to the subject product filing will be set forth on the checklist.

The transmittal forms and review standards checklists will be available on the DOI website, www.state.az.us/id, by June 30, 2001. We will strongly encourage insurers to submit completed checklists together with product filings because they are identical to those we now use for analytical purposes. We anticipate that completion and submission of checklists together with filings will significantly simplify and expedite the review process.

PROCESS FOR FILING AND DECISIONS ON PRODUCT FILINGS

We have developed a standardized process for the submission of rates and forms that are required to be filed prior to use, and the rendering of our decisions thereon. This process divides the review into two, separate segments: administrative completeness review and substantive review. The process requires that the DOI determine whether a submission is administratively complete within 15 days after receipt, and notify the filing party of its determination. It further requires that the DOI complete its substantive review and determine whether to approve or disapprove the filing within 30 days after determining that the filing is administratively complete. There are also provisions for withdrawals of filings and extensions of time to consider additional information.

The time frames included in the process are intended as maximum times. It is our objective to render final decisions on product filings as expeditiously as possible. However, to a great extent, the success of this process as a means to expedite product review decisions will depend on the degree of cooperation from insurers making filings. Insurers must take responsibility for making quality, compliant filings, and for providing prompt, responsive answers to our follow-up inquiries. We anticipate that insurers’ use of the standardized transmittal forms and review standards checklists will be critical to successfully expediting this process.

At this time, we do not contemplate subjecting filings relating to managed care products to these process requirements.

As described more fully below, we will initially implement this process through regulatory bulletin. Ultimately, we expect to promulgate it as a formal rule.

SERFF

SERFF is a project designed to provide efficiency through technology relating to the rate and form filing process. SERFF enables insurers to submit rate and form filings electronically to state reviewers and enables state reviewers to facilitate the management, analysis, disposition and storage of filings.

The DOI has entered into a licensing agreement with the NAIC to access and use SERFF. In July, 2001, a SERFF training team will train DOI staff of the use of SERFF for property and casualty and life and health rate and form filings. We anticipate being able to accept SERFF filings by October 1, 2001.

Information about SERFF, including requirements for industry participation, is available at www.serffcentral.com.

IMPLEMENTATION PLAN

Attached to this memo are the following items:

- Draft order and exhibits regarding Property and Casualty rate and form filing exemptions, commercial lines non-cancellation restriction exemptions, determination of markets with insufficient price competition, and recognized surplus lines (Ex. A)
- Draft order and exhibits regarding Life and Health advertising and policy form filing exemptions (Ex. B)
- Lists of all review standards checklists adopted by the DOI (Exs. C and D)
- Samples of a property and casualty review standards checklist and a life and health review standards checklist (Exs. E and F)
- Draft rule prescribing process for filing and approval of rate and form filings (Ex. G)

We will proceed as follows to implement these items:

- We will hold an open meeting at the DOI offices on August 1, 2001 at 9:00 a.m. to receive comment on the matters discussed in this letter. If you plan to attend, please RSVP to Kathy Linder at (602) 912-8456 by July 20, 2001. Please submit any written comments by July 27, 2001. Please note that pursuant to Arizona law we will be required to hold a separate public hearing prior to issuing the orders updating rate, form and advertising filing exemptions, non-cancellation restriction exemptions, determination of markets with insufficient price competition, and recognized surplus lines. **Other than commentary on the concept and nature of the ECP**

exemption and the Conditional Exemption for ordinary life and annuity filings described above, we ask that any commentary as to the technical content and details of these orders be withheld at this time, and reserved for the proceedings that will follow, as described immediately below.

- By September 1, 2001, we expect to issue the Notices of Hearing to commence the proceedings to issue the aforementioned orders. The hearings will be scheduled to occur approximately 30 to 45 days after the Notices of Hearing are issued. The orders will likely be issued within 30 days after the hearings.
- We will formally announce the implementation of the standardized filing transmittal forms and the review standards checklists, and will implement the standardized process for filing and review of product filings by regulatory bulletin around the same time we issue the Notices of Hearing regarding the exemption orders.
- Based on comments received and our experience in implementing these revisions to our product regulation system, we may seek the introduction of legislation in 2002 as needed.
- Sometime after the 2002 legislative session, we anticipate commencing formal rule making proceedings to promulgate the process for filing and review of product filings.

I appreciate the input, cooperation and assistance of all interested parties in modernizing our approach to product regulation to assure that this Department continues to regulate the transaction of insurance business in Arizona in a way that best serves our insurance consumers.