

E-commerce revolution has yet to take insurance market by storm

By Scott Hooper
 REGULATOR staff writer

If you keep up with the business media, you know that e-commerce is the coming thing, a whole new paradigm that's set to sweep aside the tired old economy.

But in the insurance field, in particular, the response has been distinctly underwhelming, with relatively few companies actually selling insurance products in cyberspace.

Is the industry missing something? Or is the e-commerce revolution passing insurers and regulators by? And if it is, should we be worrying about it?

First a little perspective. Last fall, or so the TV news programs told us, everyone stayed home from the mall and shopped on the Web. In reality, only about 2% of all Christmas gifts and other fourth-quarter purchases were consummated online. And Amazon.com, the most highly visible of all the Web merchants, still isn't profitable.

So e-commerce has yet to kill off the old bricks-and-mortar model of selling products to consumers any time soon. But it is likely to change it.

1% or 60%?

Take buying a car. Those widely publicized shop-by-Web car sites can take credit for a grand total of 1% of all cars sold last year. And yet fully 60% of all car buyers used the Internet to compare features and prices before driving over to the dealership.

If the same sort of thing happens to insurance — consumers

continued on page 4



In this issue. . .

Insurance regulators can't quite come to terms with electronic commerce. We recognize its value in today's marketplace, but shudder at the thought of supervising it. In this issue, we take a long look at e-commerce and its impact on the regulatory environment. In particular, we explore the role of quoting agents (a.k.a., aggregators, e-mails, or cybermalls) in helping consumers navigate through dangerous electronic waters. Our suggestion to IRES members: stop shuddering and begin reading. You won't be sorry.

— Wayne Cotter, Editor

MAY 2000

Remembering Paul	2
Continuing Ed News	7
Aggregators and the web	8
A call for restraint	10
Regulators, insurers and e-commer	12
Re-defining insurance on the Internet	14
Regulatory RoundUp	16
Scenes from San Diego school	18
Register for New Orleans CDS	23

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From the President

Remembering our friend, Paul



For those of you who have not heard, we lost a dear friend of ours. Since we knew him well, it is only fitting that we speak of him.

Paul DeAngelo served as the Assistant Commissioner of Enforcement and Consumer Protection Division of the New Jersey Department of Banking and Insurance. His responsibilities included consumer complaints, producer licensing, company and producer enforcement as well as market conduct examinations. Paul began his career with the Department in actuarial services and served the Department some 20+ years.

Paul served as chair of the NAIC's Multi-State Life Insurance Task Force and coordinated the Multi-State Market Conduct Examination of Prudential Life Insurance Company. He additionally served as the chair for the NAIC's Replacement Issues Subgroup and was serving as the chair for the Suitability Working Group.

I met Paul while he was coordinating the Multi-State examination on Prudential. My first impression of Paul was that he must be a pretty "cool" guy because he had a ponytail (like you didn't make the same assumption!). I found out much more about Paul.

Paul established a roadmap for regulators. The Prudential situation was the first of its kind. Paul kept everyone in the loop. No one participating could claim a lack of information relative to the matter. Paul worked tirelessly by calling us; advising us; faxing information; setting up teleconference calls; etc. The most important thing that Paul did for us was to keep us on the right path. In these matters, Paul exuded an air of calmness and assured us all that we were on the right path.

After the Prudential matter was over, Paul re-

continued on next page



Paul DeAngelo

Regulator extraordinaire

minded us that our job was not done. We as regulators needed to take definitive action to prevent churning and twisting. He reminded us all in a variety of ways. Paul cornered me at a NAIC meeting and advised me of the Replacement Issues Subgroup and emphasized how we all needed to participate. He went on to say that North Carolina was not represented on the subgroup. As Paul was not the type of guy that you could turn down, suffice it to say that North Carolina (as well as quite a few other states) participated on the subgroup. This group was successful in its work as evidenced by the current model law on replacements.

Just when we thought the matter finished, Paul indicated we had not addressed this matter fully as one of the concerns noted in the Prudential matter was suitability. Again, Paul took charge and reminded us of our responsibilities.

I saw Paul a few weeks ago at the IRES Foundation's "Market Conduct Regulation Program." He was doing his usual, making us look good. We had all participated in morning sessions; had lunch and were preparing for the last session. There were five of us seated at one of the tables. Janet Glover and Mary Kreuter represented the New York Department; Gene Gery and Paul were slated to represent New Jersey; and I was the representative from North Carolina. I noticed some minutes before the session

began that Paul's seat was empty. I asked Gene, "Where's Paul?"

Gene indicated that Paul was going to catch an early flight so that he could get home to his family. I jokingly said, "... and he left us here to face this crowd!" Gene replied with a smiling yes. I smiled too. I guess we both knew that Paul had already left us a roadmap.

Angela Carter
IRES PRESIDENT

Paul L. DeAngelo 1953 - 2000

Paul L. DeAngelo, 46, CIE, FLMI, served as Assistant Commissioner for the New Jersey Department of Banking and Insurance. Paul died April 5 as he was returning from a speaking engagement at the IRES Foundation seminar in San Diego.

He was born in Trenton, and lived in New Egypt, New Jersey, for 18 years.

Paul was a devoted father of three wonderful children, ages 10, 15 and 17. He was always very concerned that they have the opportunity to continue their education and follow their dreams. Friends of the family have established an education fund for the DeAngelo children: The DeAngelo Education Fund, P.O. Box 39, New Egypt, New Jersey, 08533.

Son of the late Louis DeAngelo, he is survived by his wife, Tina Duritt DeAngelo; a son, Jeremy of New Egypt; two daughters, Rita and Clara DeAngelo of New Egypt; a brother, Louis of Hamilton; and his mother, Irene DeAngelo of Trenton. He was a member of the Church of the Assumption.

Paul will be sorely missed by all IRES members.

Waiting for the e-commerce revolution

continued from page 1

comparison-shop online and then buy through traditional channels — then the Web becomes just another marketing medium, and little or no regulatory response is needed.

But if companies start to sell policies directly through consumers' personal computers, the threat of fraud and abuse begins to grow. Not from traditional companies, in all likelihood, but from scammers in the Czech Republic or Mali pretending to be U.S.-based insurance companies.

That's when state regulators will be asked why they didn't anticipate change and adapt to it before consumers were defrauded, companies disappeared and claims went unpaid.

As a matter of fact, selling insurance over the Internet is far from theoretical. Several sites — eCoverage.com and annuity.net, to name but two — already sell insurance products online. eCoverage.com is based in San Francisco, which makes it a California domestic insurer. But how do you sign up for coverage? Is an electronic signature valid? And how do you pay for it?

One part of the answer is UETA — pronounced you-Ee-ta and short for the Uniform Electronic Transactions Act — a model code adopted by a number of states, including California. UETA gives legal standing to electronic signatures, a new concept but an essential one if e-commerce is to get anywhere.

Yet in eCoverage.com's home state, the Legislature added so many exemptions — areas in which electronic signatures are not in fact valid — as to make the bill useless for many applications. In some states that have passed a version of UETA, insurance has been exempted altogether.

"Some states, Pennsylvania and some others, have

passed the UETA in what you might call a clean version: exactly as it was written," said Ray Spudeck, senior research associate with the National Association of Insurance Commissioners.

"But California exempted something like 28 sections of their insurance code," Spudeck added.

"The NAIC position was not to recommend any others that ought to be added."

Some people, including Kansas City attorney Art Chartrand, say the entire electronic signature issue is moot.

"The laws out there don't say electronic signature, but they don't say pen and paper signature either," Chartrand told a LOMA Emerging Technology Conference. "They say signature.

"I've seen no signature statutes that specify you have to use a Bic pen versus a pheasant quill either, but we don't draft legislation about those. I question whether we need all this enabling legislation for electronic commerce."

Yet those who remember how long it took to get microfilmed signatures accepted in court may feel a real need for UETA — especially since digitized signatures are a whole lot easier to forge than pen-and-ink or microfiche images.

Channel problems

The fact is, though, that with or without UETA, most insurers haven't begun to rely on e-commerce very heavily at all. And according to a survey conducted last year by Booz-Allen & Hamilton, that has little to do with regulatory issues.

Instead, insurers listed their agent networks as one of their top concerns about E-commerce.

As of last February, the Booz-Allen study found that although advanced Web-based applications could cut distribution costs by "upwards of 60%," only about 1% of the insurance Web sites surveyed featured online sales.

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An active consumer who can cheaply and easily compare prices can systematically undermine actuarial science in a fundamental way.



Waiting for the e-commerce revolution

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Fully 50% had some marketing content, 22% offered basic customer support and product information, 7% offered online quotes and 1% offered interactive customer service or online sales.

What's more, said Gil Irwin, the Booz-Allen officer who supervised the study, "Nearly all participants said they don't expect the Internet to alter their business practices materially or immediately, nor affect the industry's cost structure.

"Insurance companies are inconsistent in their approach to the Internet," Irwin added.

"On the one hand, they recognize the Internet's implications for pricing, products and service. At the same time, the industry is far from embracing the interactive potential of the Internet to serve customers in the same way that banks and brokerage firms are striving to do."

Several insurers have begun moving claims services to their Web sites, saving significant time and money for themselves and their customers.

But until they resolve what are known as channel issues — their interest in selling via the Web vs. their need to keep agents and brokers happy — companies seem unlikely to jump into e-commerce with both feet.

Daniel Finnegan, president of Quality Planning Corp., a consulting firm that advises insurers on underwriting issues, says there are some other strong business reasons to avoid selling insurance on the Web, at least for now.

Stealth attack

First, comparative shopping on the Web can be very expensive for companies, Finnegan said. If a company goes so far as to pay for a credit report and claim history, the cost could run to \$5-6 per quote — and the overall conversion rate for Web shoppers is just 1%, way lower than what it is for people who call or visit agents.

"It varies, but sales agents can close 60% of the people they talk to," he said. "It can go down to 10%

[in some markets]. But no agencies I know are closing as low as 1%.

Overall costs for a Web site may seem low when divided by the number of people who visit it, but the cost per sale can be higher than through the agents.

"Where people thought this would be the cheapest distribution channel, it could be the most expensive," said Finnegan. Which may explain why only one of the major insurers, Progressive, sells directly on the Web.

The situation may be quite analogous to auto sales on the Web. Few buy but many get price and product information. Yet even when armed with competitive information, auto buyers still end up buying from a traditional dealership, and the same manufacturers still get the business at a price they can live with.

In the case of insurance, though, Web-based price comparisons are leading to what Finnegan has called an "auto insurance pricing crisis."

Let's look at the numbers. According to a survey Finnegan's firm recently conducted, the average consumer can save 40% on auto insurance by comparison-shopping online. The industry's average profit margins are 3-5%.

"If you can get a 40% discount on the Web, and it's a 3% business, where do you think that other 37% comes from?" he asked. "The business is not over-priced 40%. Even the Ralph Naders aren't saying that."

So where are those big savings coming from?

In Finnegan's view, it's a totally inadvertent consequence of the kind of availability of information for which the Web is renowned. Insurers slice and dice the market differently, only now, for the first time, consumers are in a position to take advantage of it.

For instance, one company may have a cut point for young drivers at 24, and somebody else might have

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Still awaiting the e-commerce revolution

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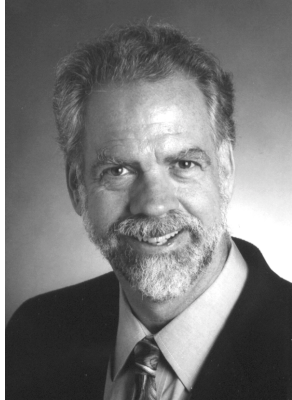
it at 22. So a 23-year-old who gets quotes from 30 companies will find one that's cheaper. Meanwhile, a big company may slice up their territories more finely than the competitor with 1% of market — who perhaps considers the entire county as the same territory.

So a 23-year-old living in a high-risk neighborhood

may come across a policy that will save him big bucks. Or someone who drives her own car 90,000 miles a year would luck into a company that doesn't keep tabs on its customers' mileage.

"You don't know that you did that," Finnegan says. "All you did was put in your information, get 30 quotes back and pick the low one."

But the really scary part of it all is that actuaries, as they currently work, can't



Finnegan: prices are 'crashing' on the web

handle this possibility.

"Actuarial science essentially pulls a bunch of people together and says, 'We assume the future's going to be like the past,'" Finnegan explains

"We might trend it or one thing or another, but people with these characteristics on the average will cost us \$100, so we'll put in our overhead and so on and charge them \$130 for insurance. But actuarial models essentially assume an inert consumer.

"An active consumer who can cheaply and easily compare prices can systematically undermine actuarial science in a fundamental way. It's a stealth attack on profitability."

Where the states are

If insurers aren't sure what to make of e-commerce, to all appearances, state regulators are no more aggressive when it comes to talking about it in public.

At least that's the conclusion that seems logical after a review of state Web sites. Only one state talked about UETA, and even with some digging, we were unable to come up with any discussion of privacy issues, fraud or any of the other topics that consumers

may have read about in the press about buying insurance over the Web.

Like the insurers, there are areas of electronic transactions that departments have jumped on with both feet. SERFF is probably the best example: a way to automate a function, but something that doesn't threaten to upset the regulatory applecart.

If regulators should be encouraging e-commerce, whether because it's a popular idea or because it can reduce transaction costs, they certainly don't seem to be doing it. And if the proper role is one of caution, of warning consumers of the risks inherent in buying insurance without sitting down with an agent, well, that seems to be lacking as well.

Meanwhile, whether or not a lot of insurance is being sold on the Web, the area is a highly volatile one.

And if Finnegan is right, out of that turmoil could come some significant changes for the entire industry.

"I've seen internal studies from four different companies," he said, "and all reached the same conclusion: Increasingly, the the market's been bimodal.

"There are consumers who just expect good service — that's what they buy, they assume it, and they're shopping generically for price. And then there's another group of consumers who tend to be older, who are loyal to companies. . .who tend to have personal contact with their sales agent. Those are two very different markets."

It's hard to know whether that's a transition thing, or whether we're in for long-term changes in the way insurance products are sold, Finnegan said.

"Increasingly insurance is a commodity, and I don't know how far that goes. I don't think anybody does know. I know we have a split market, and everybody's seeing it. We know the trend is toward commoditization, but how far that trend can go is anyone's guess, I think."

The cars-on-the-web example might be instructive, he said, with the Web knocking down prices.

"Consumer information is spreading around, and that is potentially causing a sea change," Finnegan said.

"We did an estimate recently where we said that for every 1% of the market that shops on the Internet, there's an 8% drop in industry profitability. The problem is really fundamental." ■

C.E. News

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Attention Regulators: What innovative approaches is your state using to attract qualified examiners? If you think your state has a story worth sharing with other regulators, please contact Wayne Cotter, via quepasa@sprintmail.com

The role of 'aggregators' in internet insurance sales

By Ron Kuhnel and Eric Loewe

The Internet is an attractive distribution and fulfillment channel for insurance, and consumers clearly are interested."

The major aggregators such as InsWeb and Insuremarket have had great success in attracting shoppers to their web sites. In addition, these sites are successful in accomplishing their objectives. A recent survey by one aggregator indicated that 44% of customers that completed a shopping session had switched insurance carriers. This indicates the consumer is benefiting from the Internet in a major way.

Traditional insurance companies with strong balance sheets and good brand equity have recognized the need to leverage the Internet. However, many are constrained, by a variety of reasons, from rapidly establishing a major presence directly. A good solution for these companies is to partner with an aggregator.

Driven then by market pressures and consumer demand, such aggregators are enjoying major growth as consumers learn the benefits to be derived from online shopping. These aggregators, which function like an on-line agencies/shopping malls are also sometimes called "insurance cybermalls". The basic principle of such an e-commerce intermediary is to provide the consumer with an unbiased marketplace to compare insurance products and prices, and if the consumer is interested in possible purchase to provide a capability to connect with an agent or possibly purchase the product directly from the web site.

Mr. Kuhnel is an e-commerce consultant for InsWeb, which is based in Redwood, Calif. He is the former Chief of Information Management for the California Department of Insurance. Eric Loewe is Associate General Counsel for InsWeb.

There are a variety of approaches to this, but the common theme is to provide the consumer a way to compare prices by filling out a single quote form and then provide a list of insurers interested in the business and their prices. In the last few years, the major aggregators have generated web traffic rivaling the nation's largest insurers.



Not all insurers are enamored by these developments since they intensify the pressure to compete more actively on price. Nevertheless, this is a trend that can be expected to continue.

It is also typical of such insurance aggregators to provide access to both general and specific insurance information. This is a particular strength of the Internet, and can be accomplished through the use of frequently asked questions (FAQ's) and other means such as insurance analyzer software. This way it is possible to give a consumer a very large amount of information such as suggested amounts of insurance coverage to fit specific situations or recommend particular forms of coverage.

'Aggregators' and insurance sales over the Internet

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A glossary of insurance terms and access to articles by experts and consumer groups can all add greatly to the ability of the consumer to make educated choices. Unlike price comparisons, nearly all insurers embrace this, as an educated consumer is probably more likely to purchase coverage than an uneducated one.

The more successful aggregators have a number of characteristics that separate them from the competition. Many have a large number of different insurance products — property and casualty as well as life and health. In addition, they'll be offering products from a large number of well-known and respected insurers. Finally, the web site itself will be well designed, of high performance with little or no delays in returning pages, and protective of the consumer's privacy and security. Not all such web sites meet these criteria, but the competitive marketplace and vigilant regulators will tend to weed out the ones that come up short.

One of the major advantages to be gained by the aggregator is aggregation of data, such as customer files and preferences. This, however, may not be readily available to the aggregator. Major concerns about both privacy and unfair competitive advantage are already being raised by regulators in all areas, even in the case of merged companies, and any attempt by a third party to do the same may well meet with substantial regulatory resistance. Nevertheless, with care taken to ensure that aggregation is kept at a high enough level, such as integrated advertising, click-throughs to related markets, and the like, there is no reason why this cannot become a viable role for some aggregators.

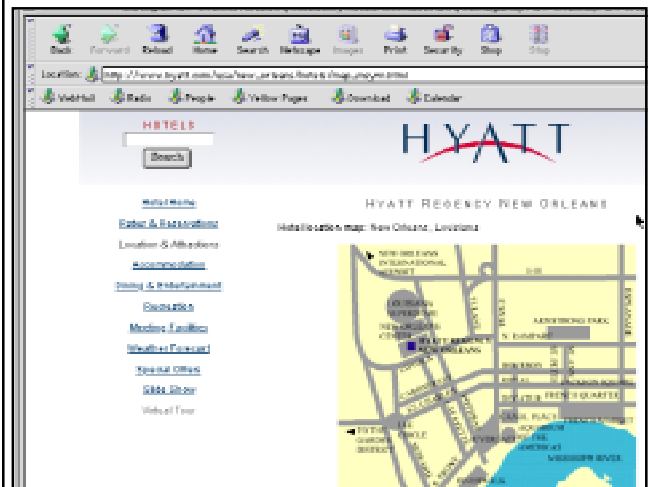
There has been some concern that the aggregators would fall under the influence of the major insurers, reducing their independence and therefore consumer confidence. Thus far this has failed to materialize, and the major aggregators have continued to provide independent and accurate quotes. In fact some insurers have begun to offer quoting systems on their own web sites, even showing competing insurers with lower prices, and relying on other factors such as strength of assets, claims paying performance, and overall con-

sumer service to attract and retain customers.

So while the expectation is that major insurers will continue to enhance their own web sites this trend will only reinforce the principle of comparison shopping for insurance, the aggregators particular strength.

In summary, e-business is most certainly with us and the aggregator will continue to provide an important role. While most conventional insurance companies will continue to grow their on-line business, and on-line binding allowing direct sales will become a reality in the near future, an increasingly well educated consumer will continue to look for ways to compare prices, get unbiased advice, and complete the sale on-line. The aggregator is uniquely positioned to accomplish this successfully. ■

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A Call for RESTRAINT

by Wayne Cotter
REGULATOR Editor

EDITOR'S NOTE Arthur J. Chartrand, a national insurance regulatory legal consultant, has been following insurance and e-commerce issues since the emergence of the World Wide Web. The following reflect his thoughts on what regulators should be doing to help insurers embrace the new technology.

Very few insurance transactions are being fully consummated on the Web, says Art Chartrand, a former NAIC counsel. "I've done no empirical studies on the matter," he acknowledges, "but my strong suspicion is that most consumers are obtaining quotes and seeking advice through the Internet, but the deal is invariably closed through a human intermediary—an agent calls or an application is mailed."

He dismisses suggestions that perhaps consumers are a bit leery of transmitting large sums of money to insurers via their computers noting their willingness to shell out big bucks for home electronics, computers, and even automobiles over the Internet. It's a good point, but it begs the question: Why not insurance?

Chartrand places much of the blame for the industry's lackluster presence in the new market with regulators who are failing to send the right message to insurers. "Regulators should be embracing the new technology," says Chartrand, "but instead many are sending signals that tend to stifle innovation."

"We have been blessed with a ten-year period in which liquidations and rehabilitations have been virtually nonexistent," says Chartrand. "As a result, many states have shifted their focus to various techni-

*Are we over-reacting to
insurance regulatory issues
created by the internet?*

*One observer thinks everyone
should relax a little.*

cal infractions, boosting fines to astronomical levels without thinking whether these infractions really have hurt the consumer." Companies fear, Chartrand says, that this same mindset is likely to pervade the electronic marketplace should insurers choose to make a full-fledged commitment.

They envision insurance department examiners seeking out traditional paper trails, including handwritten signatures, in a marketplace that does not readily lend itself to such an approach. Insurers also question, he says, whether it makes sense to totally revamp their methods of conducting business if only a handful of states will support such efforts.

"I understand regulators can't condone an 'anything goes' policy," says Chartrand, "but when certain states are having serious discussions on whether all insurer web sites should conform to one standard, I think we've gone over the edge on regulatory control of e-commerce."

"Restraint is the key word," Chartrand stresses. He points to Illinois, North Carolina, Kansas and Nebraska as states that are models of restraint when it comes to letting insurers test the market in new and innovative ways. "Texas and New Jersey will also work with you if you have a new idea," says Chartrand. He likes



Chartrand on technology:
Join it, don't fight it.

Chartrand on technology

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Arkansas Commissioner Mike Pickens' approach and notes that New York is far more open to innovation than in past years and also boasts a "seasoned staff" that truly understands industry problems. On the other hand, California continues to be a challenge for those seeking innovative solutions to complex problems.

Laws and Regulations

What then should regulators be doing to monitor the e-commerce market? In Chartrand's opinion: Get out of the way and see where the train is headed.

Chartrand suggests that what we don't need is a "flurry of new laws and regulations" to deal with any perceived problems associated with e-commerce. "Most of the current laws are sufficient," he says, "provided they are interpreted broadly." He thinks that people who spend inordinate amounts of time thinking about where a cyberspace transaction actually takes place "probably have too much time on their hands."

Current laws require that insurers must be licensed to transact business within a state. Thus it's Chartrand's position the appropriate situs of an individual insurance transaction is the purchaser's primary residence. "It's just common sense," says Chartrand, "since individuals can't have multiple primary residences, the issue really is a no-brainer."

"If too many laws and regulations are drafted in the wake of e-commerce," warns Chartrand, "we may freeze ourselves in time." His contention is that today's technology may become obsolete long before most of us imagine. New forms of electronic commerce will be here and regulators will be compelled to



If too many laws are drafted in the wake of e-commerce, we may freeze ourselves in time.



develop whole new rounds of statutes and regulations to replace the ones now being implemented.

Agents & Brokers

When it comes to agents and brokers, Chartrand still pleads "restraint." So-called "quoting agents" (Chartrand prefers the term "e-malls"), such as InsWeb, are not really agents in Chartrand's view, and should not be required to be licensed. "When you think about it, e-malls function much more like a newspaper ad or a *Consumer Reports* article," says Chartrand. "They provide information for the consumer." There will be times, however, when such entities cross the line and begin dispensing advice. At that point, says Chartrand, they would be functioning as agents and should be licensed as such.

With respect to commissions, Chartrand believes e-malls deserve compensation if they are generating business for insurers regardless of whether they have a producer's license. Commissions for e-malls would only encourage more quoting services and ultimately more information for consumers to comparison shop.



"Get out of the way and see where train is headed."

No time for Uniformity

Contrary to recent NAIC pronouncements, this is not the time, Chartrand believes, for more uniformity when it comes to e-commerce. "The last thing we want to do with e-commerce is stifle growth by imposing one monolithic set of rules and standards," says Chartrand. "We need to encourage experimentation, creativity and entrepreneurship in any way we can."

Regulators, Chartrand believes, should be unified with respect to embracing the new technology, but that should not spill over to a unified set of standards to deal with it. "After all," he asks, "why have 50 regulators if we're just going to adopt one approach?" ■



A look at how the Internet can help insurers improve their relationships with regulators

by Steve Feldman, InSystems

Now that Y2K is just a distant memory, insurers are making e-commerce a high priority. Industry executives are demanding that e-commerce strategies be implemented as quickly as possible to address the changing insurance business environment.

The Internet's impact on sales is significant. But equally significant is its impact on the vital carrier-to-regulator relationship. As a result, insurers need to redefine their regulatory compliance strategies to remain competitive.

The typical process for launching an insurance product takes months to reach the marketplace. At the end of the day, it is critical to ensure that what has been approved by the DOI is indeed what is being sold, underwritten and serviced. As many insurers have discovered, the cost of non-compliance — from market introduction delays to financial penalties resulting from market conduct exams — can be staggering.

Internet-based technology solutions (whether portals or Application Service Providers/ASPs) are playing an increasingly pivotal role in facilitating the carrier-to-regulator relationship that affects an insurer's ability to get product to market quickly.

More and more new insurance products are flowing into the marketplace at a rapid rate. This means even more frequent contact between carrier and regulator in the effort to win approval of new or changed products. This, in turn will encourage the adoption of e-business processes and stimulate increases in technology spending.

From 'Document-Centered' to 'Internet-Centered' Relationships

Traditionally, relationships in the insurance industry have been defined by the delivery of documents — the 'product.' In the new economy, the product is the

relationship, and these relationships need to meet the demands for immediacy and customization.

Leveraging the Internet to accelerate and improve communications will provide insurance companies with the forms and information they need to comply with regulations in a more cost-efficient manner. By filing on-line, paperwork is eliminated and return on investment is more quickly realized.

Internet-based solutions can facilitate communication and collaboration between regulators and insurers through a central location where products can be monitored and tracked in real time.

Insurance compliance via the Internet

George Nichols, President of NAIC has said, "Only the fleet footed will survive in the new world created by the Gramm-

Leach-Bliley Act."

Compliance is higher on the agenda of insurance companies as evidenced by the increase in higher-profile market conduct fines and more companies introducing the role of a Chief Compliance Officer (CCO). As compliance professionals migrate to the Internet, they should be looking for solutions that contribute to stronger relationship with regulators, decrease the time it takes to get a product to the market, decrease costs and increase productivity. These solutions must offer completely secure, 24-hour access.

Compliance solutions like customized web portals can offer a number of benefits, in both life-health and property-casualty products. They facilitate relationships by creating a community between insurers and regulators where the 'portal' acts as the access door. In addition, they:

- ◆ Enable senior management to consolidate and track their product development information while providing the ability to manage projects, filings and activities related to product development across



Using the web to improve insurer-regulator relations

continued from previous page

multiple business units

- ◆ Offer direct interaction with regulators over the Internet
- ◆ Dramatically decrease the research and development times for new product offerings
- ◆ Facilitate on-line filings
- ◆ Enable faster product launches
- ◆ Provide access to expert help, up-to-date information on the topical issues of the day, access to industry and State links and third-party resources
- ◆ Reduce the risk of market conduct exams and penalties

Demystifying ASPs and Portals:

An Application Service Provider (ASP) is a company that provides programs and services over the Internet that might at one time have been resident on a personal computer or enterprise system.

ASPs provide remote access services, essentially an off-premises Local Area Network (LAN) to which mobile or remote users can be connected. They provide access to specialized applications that would be expensive to install and maintain locally. These applications are provided on a pay-per-use or yearly license fee basis.

In the case of Compliance, an ASP could be hosted by a technology vendor. Along with the basic benefits of compliance automation, an ASP will allow for lower capital costs for implementation/integration, minimizing the need for MIS involvement. Since this application is hosted and available remotely through the Internet, this provides for a significantly shortened implementation cycle and provides instant real-time monitoring.

Portals, as defined by the Internet, serve as gateways to the Web and as an anchor site. Portal sites offer a directory of related sites to which the user can link. They offer users a sense of community. Portals offer the ability to create a site that can be customized to reflect individual interests. A Compliance Portal for insurance companies and regulators would be customizable and would facilitate collabo-

ration by providing compliance information and an easy-to-navigate interface.

A Compliance Portal needs to be the source of up-to-date regulatory filing forms and industry news while providing ways to collaborate. The National Association of Insurance Commissioners has formed a task force with insurance regulators to examine electronic compliance filing, which would be facilitated through a Compliance Portal. Where SERFF is designed to facilitate filings from a carrier to the insurance department, it requires the use of Lotus Notes for its infrastructure, which can be expensive for both parties.

A Compliance Portal is less costly. It uses the Internet to serve as an online virtual meeting center where topical issues can be discussed between the industry and regulators without anyone needing to leave their office. Since discussion is in real-time and immediate, users would have the benefit of being able to share and collaborate on issues with minimal cost.

Revolutionary change

Insurers need to find the most effective means to speed up the filing process, reduce expenses and limit their exposure to regulatory penalties and disruptive market conduct audits that can result from the sale of non-compliant products.

The Internet is changing expectations and demands while providing an opportunity for companies to update their business processes.

The emergence of the Internet as a globally accessible, interactive medium provides the impetus for insurers to respond to regulatory and market challenges. It also enables the creation of relationships between compliance and the regulatory community in a business where products are becoming increasingly regulated and time-to-market often determines winners and losers. ■

Steve Feldman is a Product Manager with InSystems Technologies, an international provider of relationship management solutions for the insurance industry. The firm is based in Toronto.

Insurance on the internet forces regulators to question old definitions, old concepts

By Douglas A. Greer

When insurance regulators first focused on the Internet, many were skeptical of its potential as a new medium for business. Now, even in light of the recent ups and downs of the stock market, no one seems to question that the Internet has caused an explosion in communications that has permanently changed the way in which business is done. Although it has been somewhat slower to go on-line than other businesses, the insurance industry has made a significant commitment to electronic commerce in a short time.

This has resulted in new marketing practices as well as consumer and business relationships in the insurance industry. As these changes have occurred, issues have arisen that have challenged the application of existing laws and call for new legislative and regulatory responses. The rapid growth of the Internet has not permitted regulators the luxury of addressing such issues one by one. Instead, regulators have been forced to take on a significant number of issues at one time. How are regulators responding to these challenges? What concerns does the industry presently have?

Internet Advertising

The content of advertising on the Internet is no

Mr. Greer is with the Los Angeles law firm of Cotkin, Collins, Ginsburg. His principal areas of practice include insurance litigation, business litigation and civil litigation.

different from advertising in the traditional media. Insurance advertising laws and regulations are based on the prohibition against false or misleading statements about an insurer's product or a competitor's. There is no reason, therefore, why the rules governing advertising in general would not apply to the Internet.

In its 1998 "White Paper," the NAIC's Internet Marketing Subcommittee recognized this, but correctly noted that some changes in these laws are may be needed to address new situations. For instance, it is difficult to identify who has made statements on the Internet concerning an insurer's products and service, and whether the insurer has sustained any damage. Examples of such statements are e-mail or comments made in chat groups.

Obviously, some situations will remain unaffected. Brokers and agents disseminating comparative information regarding insurance products are currently subject to state regulatory oversight. The White Paper noted that the transmission of insurance information over the Internet is advertising which is regulated by state insurance laws. For instance, a life insurer's website should constitute an advertisement under the NAIC Model Rules Governing the Advertising of Life Insurance.

It is also possible that the on-line service provider may share in potential liability or regulatory action. However, the states that have brought actions against advertisers on the Internet, notably Minnesota and Pennsylvania, have focused on the individuals or businesses placing the advertisements and not the Internet service provider.

Importantly, the NAIC has recognized that the Internet offers regulators their own opportunity to go



New definitions, new concepts on the Internet

continued from previous page

on-line and actively monitor market conduct. The paper recommended that regulators access company and agent web sites to monitor advertising and marketing activity. The White Paper also recommended that states permit insurers and agents to file advertisements electronically for pre-approval. Virtually all departments of insurance now have their own web sites.

Hopefully, regulators will approach these issues with uniformity in mind. Jurisdictional problems can result in the application of multiple and inconsistent laws and regulations to a single advertisement or website.

Transactions on the Internet

Federal and State legislators have grown increasingly more aggressive in regulating commerce on the Internet. For example, a new Article 2-B, which will regulate the sale of goods on the Internet, has been proposed as an amendment to the Uniform Commercial Code. Additionally, the Federal Telecommunications Act of 1996, 47 U.S.C. § 223(a)-(h), applies to Internet transactions. The Federal Trade Commission regulates unfair competition in the marketplace, including unfair or deceptive acts or practices that injure customers. The Federal Trade Commission Act, 15 U.S.C. § 45, grants the FTC the power to pursue a variety of civil and criminal acts with respect to proscribed advertising practices.

Some state legislatures are also moving to regulate Internet commerce. At least 12 states have enacted provisions affording legal standing for electronic signatures, generally by adopting a version of the Uniform Electronic Transactions Act. The NAIC White Paper particularly stressed the need for uniform standards for the use of electronic or digital signatures to ensure the efficacy of transactions over the Internet.

Unfortunately, the states have clearly not been “uniform” in adopting the model code, some enacting it

in its entirety and some, like California, making numerous exemptions. Some states have even exempted insurance from the Act entirely. It is therefore likely that attempts to regulate Internet insurance transactions on a state-by-state basis will result in some confusion to the industry.

Another the NAIC has studied is providing a legally acceptable means for electronic payment of premium. The White Paper recommends that regulators examine and update their current laws and regulations

regarding the use of credit cards so as not to impede the growth of electronic commerce.

As the White Paper states, regulators generally believe that a sufficient framework already exists to address most potential problems posed by the insurance activities on the Internet. However, due to the various state regulations, Internet insurance sales cannot always be

conducted in a uniform manner.

Whose Laws Apply?

As can be seen from the preceding paragraphs, some of the most important issues confronting regulators are jurisdictional. One issue that must be resolved is whether the Internet is subject to regulation at the state or federal level, or both.

It is unclear, for instance, whether an insurance transaction on the Internet is an electronic transmission in commerce, to be regulated under the Commerce Clause by the Federal Government, or whether it is an insurance transaction, to be regulated under the McCarran-Ferguson Act (15 U.S.C. § 1012) by state regulators. The NAIC’s White Paper notes that insurance regulators believe that the business of insurance is regulated by the states, regardless of the medium in

continued on page 21



Is the solicitation made when the broker or insurer displays a rate page or rate comparison chart, or is it made when the information is viewed or downloaded? Is there a solicitation made by simply registering a website?



REGULATORY ROUNDUP

MICHIGAN — Misrepresentation in Submitting a Claim Will Not Invalidate An Entire No-Fault Auto Policy

The Court of Appeals of Michigan affirmed a lower court's invalidation of a no-fault auto insurance policy provision (the "policy voiding provision") that declared the entire policy void if the insured intentionally concealed or misrepresented facts relating to claims made under the policy. In this case, plaintiff submitted a fraudulent wage-loss verification form and a letter from her employer stating that she had been terminated from employment on a specific date. In accordance with the policy voiding provision, the insurer rejected plaintiff's claim for uninsured motorist benefits. The court held that the policy voiding provision violated the Michigan Financial Responsibility Act, which provides in relevant part that an insurer's liability becomes absolute after any injury or damage covered by the policy occurs. While an insurer may rescind an entire policy if the insured obtains the policy through intentional misrepresentation of a material fact, it may not do so where the insured allegedly filed fraudulent claims under a valid policy. The court did, however, rule in favor of the insurer on the two other issues raised on appeal. The court held that the insurer had successfully stated a claim of common-law fraud. Also, the court held that the trial court had erroneously ordered to arbitration the insurer's counterclaim for fraud. See *Cohen v. Auto Club Ins. Ass'n*, 606 N.W.2d 664 (Mich. Ct. App. 1999).

PENNSYLVANIA — Proposed Legislation Would Restrict An Insurer's Use of "Aftermarket Parts"

Proposed Senate Bill 1207 would amend the Motor Vehicle Physical Damage Appraiser Act of 1972 (the

The New York-based Stroock & Stroock & Lavan LLP Insurance Regulatory/Corporate Practice Group includes Donald D. Gabay, Martin Minkowitz, William D. Latza, and Vincent Laurenzano, an insurance finance consultant. They gratefully acknowledge the assistance of Todd Zornik, a law clerk at Stroock.

By Stroock & Stroock & Lavan

"Act") to prohibit an appraiser from preparing an independent appraisal of damages that is based on the use of "aftermarket parts." The bill defines an aftermarket part as "a part which has not been designed and manufactured and which does not function to the specifications set forth by the manufacturer of a motor vehicle". Thus, the bill appears to resolve the central question – whether aftermarket parts are in fact of like kind and quality to original equipment manufacturer ("OEM") parts – by defining them differently than "equivalent parts". In addition, the bill would prohibit any appraiser or insurer from requiring an auto repair shop to use parts other than OEM parts while the vehicle is under manufacturer warranty, or for five years from the date of original purchase, whichever is longer. Senate Bill 1207 would also direct the Secretary of the Commonwealth to promulgate rules in connection with the amended Act. The Insurance Commissioner would remain responsible for the "administration" — but not the "enforcement" of — the Act. Full bill text is available on the Web at www.legis.state.pa.us/WU01/LI/BI/BT/1999/0/SB1207P1529.HTM.

TEXAS — Article 5.07-1(a) of the Insurance Code Does Not Preclude Insurers from Basing Claims Reimbursement on the Cost of Non-OEM Parts of Like Kind and Quality

The Court of Appeals of Texas, Third District, upheld a trial court's decision to grant summary judgment in favor of an insurer sued for allegedly violating Article 5.07-1(a) of the Texas Insurance Code by refusing to cover the full cost of original equipment manufacturer ("OEM") replacement parts under plaintiffs' standard Texas personal automobile insurance policies. The court held that Article 5.07-1(a), which prohibits an insurer from specifying the types of parts to be used in the repair of a vehicle, does not require an insurer to pay for new OEM parts to the exclusion of all other

parts. The court concluded that the standard Texas automobile insurance policy's provision of reimbursement only for the cost of non-OEM parts of like kind and quality is not inconsistent with Article 5.07-1(a). While an insurer may not require a policyholder to accept non-OEM parts, it may pay claims based on the cost of non-OEM parts which are of like kind and quality relative to original manufacturer parts. See *Berry v. State Farm Mut. Auto. Ins. Co.*, 9 S.W.3d 884 (Tex. Ct. App. 2000).

ARIZONA — The “Fairly Debatable” Value of A Claim Does Not Itself Defeat A Bad Faith Claim Against An Auto Insurer

The Supreme Court of Arizona rejected the opinion of the Court of Appeals that an auto insurer's poor practice and bad motives are irrelevant in a bad faith action where the insurer is alleged to have refused to pay the policy limits of an underinsured motorist claim, provided that the claim was fairly debatable. Instead, the Supreme Court ruled that in defending a fairly debatable claim, an insurer must further show that it exercised reasonable care and good faith. The court reasoned that there was sufficient evidence in this case for the jury to conclude that the insurer knowingly acted unreasonably in settling the plaintiff's claim. The court alluded to evidence suggesting that the insurer had set arbitrary goals for the reduction of paid claims and intentionally delayed settlement of plaintiff's claim. Consequently, the court vacated the original opinion of the Court of Appeals and remanded the case to that court for consideration of the other issues raised on appeal. See *Zilisch v. State Farm Mut. Auto. Ins. Co.*, 2000 WL 236346 (Ariz.).

MASSACHUSETTS — Governor Signs Bill Permitting the Sale of Combination Products

On February 18, 2000, Governor Paul Cellucci signed into law Senate Bill 1996, which permits insurers to combine any form of accident and sickness insurance coverage with an annuity, life or endowment policy. While the new law authorizes the combination of a variety of coverages, Senate Bill 1996 received particular attention from legislators seeking ways to support the private long-term care insurance market. It is expected that the law initially will be utilized by

insurers that seek to market life insurance policies and annuities that provide long-term care insurance benefits. Senate Bill 1996 amends Section 22A of chapter 175 of the General Laws, which previously prohibited the combinations set forth in the bill. Full bill text is available on the Web at www.state.ma.us/legis/laws/seslaw00/sl000033.htm.

TEXAS — Department of Insurance Provides Guidance on the Use of Electronic Commerce in the Sale of Insurance

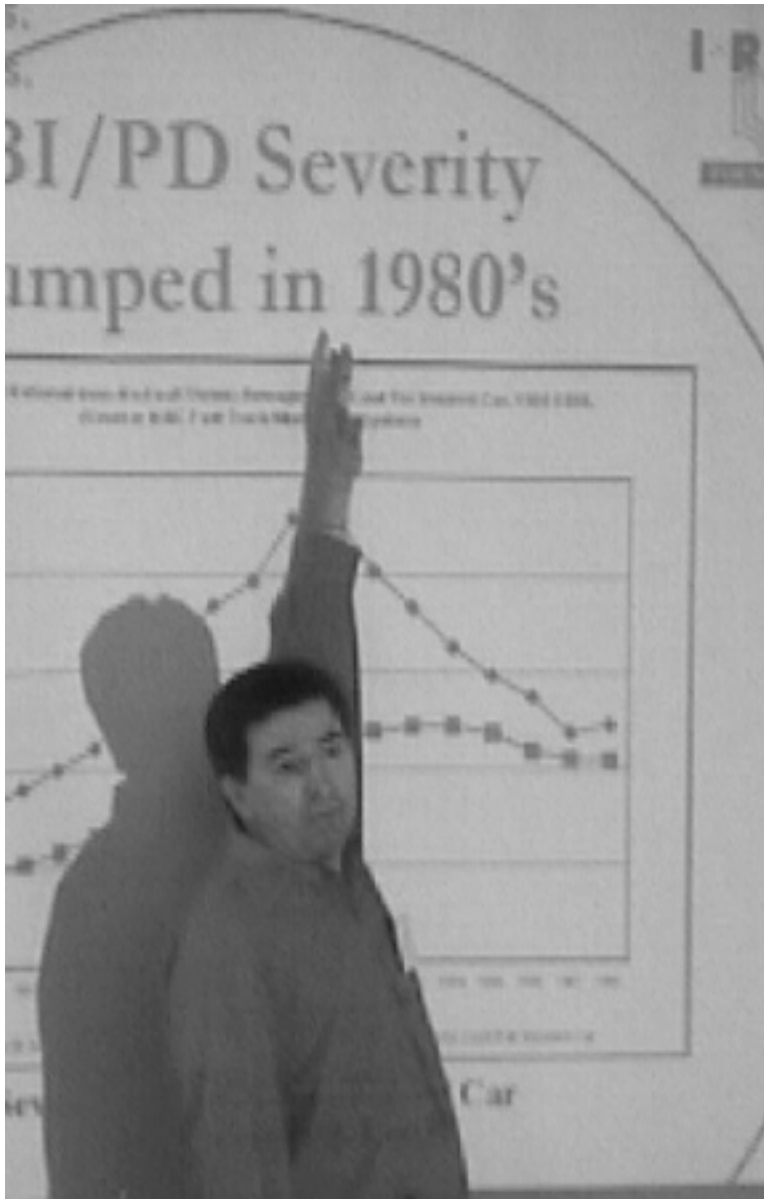
The Texas Department of Insurance issued a new bulletin to provide guidance on the use of electronic commerce in the marketing and delivery of insurance and other regulated products to Texas residents. The bulletin states that, in the absence of laws and rules specifically governing the electronic sale of insurance to Texas residents, insurers utilizing electronic commerce must comply with statutes and rules applicable to standard insurance transactions. The bulletin sets forth a non-exhaustive list of regulatory issues that insurers should consider when engaging in electronic commerce. For example, any insurer or agent engaged in the business of insurance in Texas in any form must be properly licensed in the state. Similarly, any Internet site marketing insurance to Texas residents must comply with Texas advertising laws and rules. The Department expects to provide additional guidance in this area as electronic commerce and the laws governing it continue to evolve. For more information, see TX Bulletin B-0012-00 (available on the Web at www.tdi.state.tx.us/commish/b-0012-0.html).

IRES CDS: Next Up

- **2000 — New Orleans. July 30-Aug. 1 Hyatt Regency**
- **2001 — Baltimore. Aug. 5-7 Hyatt Regency Inner Harbor**
- **2002 — San Antonio. July 28-30 Hyatt Regency**

Back to the beach

Insurance industry leaders reconvene on the ocean in San Diego to be instructed in the current ways of market conduct examination



About 250 industry members attended the 7th Annual IRES Foundation Market Regulation School April 2-4, 2000 at the Loew's Coronado Hotel in San Diego.

This year's theme was "Market Conduct Regulation — Focus on the Future" could not be more appropriate as we head into year 2000. Along with the program fundamentals of market conduct regulation by each state, special sessions focused on banking, privacy and confidentiality, and electronic commerce.

The school brings insurance industry executives and experts together with insurance department staff from various states to learn how each state enforces its market conduct-related rules and regulations.

The proceeds from all IRES Foundation educational programs help raise funds for insurance regulator education programs.

For more information on the Foundation and its programs, call 913-768-4700.



TOP LEFT: Ken Cooley of State Farm reaches high to make a point during a presentation on auto claims in California. ABOVE: Joel Ario of the Oregon Insurance Department answers questions during the state "roundtable" question-answer sessions. AT LEFT: IRES Foundation President Bruce Foudree.



CLOCKWISE FROM TOP: A panel of regulators responds to industry questions during the school's final session. . . Audience members are given lots of opportunities to pepper the regulators with questions. . . Illinois Insurance Department staff meets with industry officials during the Tuesday morning "State Roundtable" sessions. . . The school's opening reception was set against a majestic ocean view. . . Pam Martin from Washington State Insurance Department meets with a table-full of industry leaders. . . Comedian Rex Havens tickles the audience with his lunch-time humor.



**Visit the IRES Foundation web site
at www.ires-Foundation.org**

A Nichols' worth on market conduct

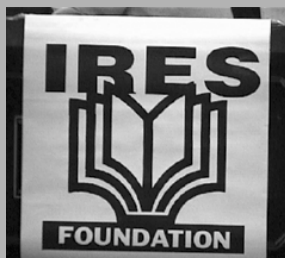
“The success of modernizing what we do will be the result of a partnership — among regulators, companies, agents and consumers.”

“The states need to develop a market conduct program at the regulatory level. What are we going to go look at? When are we going to go look at it? I believe that states that do not have a formal program, are going to have to develop one.”

“Market conduct folks have to step up to the plate. Companies should develop a self-auditing system. Plain and simple. We expect you to have an effective, structured compliance program. You should not wait for me or any regulator. You should be doing it yourself, if you value your customers — to make sure they're being treated right.”



**Excerpts from
the keynote address
by NAIC President
George Nichols of Kentucky,
at the 7th annual
Market Conduct School
of the IRES Foundation
April 3, 2000**



E-commerce forces regulators to re-define insurance concepts

continued from page 15

which the transaction takes place. Regulators therefore feel that it is not necessary to drastically alter their structure in response to the Internet.

Another jurisdictional issue is the location or "situs" of an internet transaction. It is difficult to determine when and where an insurance solicitation takes place on the Internet. Obviously, this must be known in the event it is necessary to determine which state's laws or regulations will apply. Is the solicitation made when the broker or insurer displays a rate page or rate comparison chart, or is it made when the information is viewed or downloaded? Is there a solicitation made by simply registering a website? Putting a web page on a server is, of course, an invitation for everyone to visit, read and react to the content of the site.

The location of an actual sale of insurance can have a wide-ranging impact on the rights and interests of the parties. Issues as diverse as premium taxation, the applicability of guaranty funds, policy termination, continuation of coverage, cancellation and non-renewal, binding authority, commission sharing, and rebates can be strongly affected by the determination of the location of the transaction, since the law regarding these issues differs from state to state.

The location of a transaction also impacts licensing, because the transmission of insurance information over the Internet creates the possibility of a potential sale in every state, regardless of whether the insurer or producer is licensed in the state where the consumer resides or does business.

Since there is no regulation of "cyberspace," insurance regulators will have to decide the location of an Internet transaction. Given that a single advertisement or web site can lead to an insurance transaction in each of the 50 states, it seems critical that regulators develop a uniform approach to these issues.

Facilitating e-commerce

These are among the numerous issues that are currently being addressed by legislators and regulators as the Internet becomes an increasingly larger part of the commercial marketplace. Answers are needed, and

must be determined quickly. Until they are, however, it will continue to be difficult to determine what laws apply to business conducted over the worldwide web.

From the perspective of the industry, this gives rise to two important questions: How quickly will regulators and legislators take steps to resolve these issues? Will their approach be sufficiently uniform to permit the development of Internet marketing practices? Undoubtedly, the insurance industry, like other segments of American business, will be driven to fully explore the possibilities of e-commerce.

This desire will be heightened by the new participants in the insurance industry, who, wake of the 1999 Financial Reform Act, are already accustomed to doing a business over the Internet. Regulators will need to be sensitive to the changing methods of transacting insurance business and work closely with their state legislators to facilitate the transition to electronic commerce. ■

WANTED: NEW MEMBERS

IRES welcomes all state insurance regulators as general members, Accredited Insurance Examiners (AIEs), or Certified Insurance Examiners (CIEs).

Corporate sponsors can help support IRES through a Sustaining Membership.

For more information, see our website at www.go-ires.org or call our office in Kansas City at 913-768-4700. Or send us an e-mail at ireshq@swbell.net.

And remember: "The Regulator" newsletter is free to all IRES members.

Al Greer Achievement Award Nomination Form

The Al Greer Award was conceived in 1997 and will annually honor an examiner who not only embodies the dedication, knowledge and tenacity of a professional regulator, but exceeds those standards. Current members of IRES Board of Directors are not eligible for nomination.

A. Basic requirements for nominees include the following:

- (1) Five (5) years as an IRES regulator member and a current member
- (2) Ten (10) years regulatory experience

B. Nomination procedure requirements:

- (1) Completed nomination form
- (2) Validation of nomination must be signed by at least three (3) current IRES regulatory members
- (3) Attach a nomination letter of not fewer than 50 words or more than 100 words
- (4) Please return completed *form* and *nomination letter* to: IRES (Al Greer Achievement Award),
130 N. Cherry, Suite 202, Olathe, KS 66061

NOMINEE INFORMATION:

Name: _____

Address: _____

Telephone: Work: _____ Home: _____

FAX: _____

Education / Designations: _____

Insurance Regulatory Examination Experience:

Current Position and Employer:

(make note if nominee is a contract examiner and give jurisdiction currently contracted with)

NOMINATION VALIDATION:

(signature/name of three current members making nomination)

Signature/Name

Signature/Name

Signature/Name

Selection Process

The Al Greer Achievement Award Sub-committee will then determine which nominees meet the nomination requirements.

Nominees making it through the sub-committee process will be voted on by the members of the Membership and Benefits Committee with the nominee receiving the most votes being the recipient of the award. In case of a tie the entire Board of Directors will vote to determine the winner. (In either instance, only one vote per committee member or board member.)

The counting of votes will be conducted by the chair and vice-chair of the Membership and Benefits Committee along with the executive secretary of IRES. The winner will be kept confidential until announced at the next CDS.

IRES 2000 Career Development Seminar

JULY 30-AUG. 1, 2000 NEW ORLEANS

HYATT REGENCY NEW ORLEANS

Official Registration Form

Fill out and mail to The Insurance Regulatory Examiners Society
130 N. Cherry, Suite 202, Olathe, KS 66061

Yes! Sign me up for the Year 2000 IRES Career Development Seminar. My check payable to IRES is enclosed.

Seminar Fees

(includes lunch, cont. breakfast and snack breaks for both days)

Check box that applies

- IRES Member (regulator) \$225
 Industry Sustaining Member ... \$375
 Non-Member Regulator \$325
 Retired IRES Member \$90
 Industry, Non-Sustaining Member \$650
 Spouse/guest meal fee \$70

Name _____

Title _____

First name for Badge _____

Insurance department or organization _____

Your mailing address _____ Indicate: Home Business

City, State, ZIP _____

Area code and phone _____

\$

Amount enclosed _____

Spouse/Guest name _____

If registering after July 1, add \$40.00. No registration is guaranteed until payment is received by IRES.

Hotel Rooms: You must book your hotel room directly with the Hyatt Regency. The room rate for IRES attendees is \$120 per night for single-double rooms. Please call group reservations at 800-233-1234 or 504-561-1234. The IRES convention rate is available until July 9, 2000 and on a space-available basis thereafter.

SPECIAL NEEDS: If you have special needs addressed by the Americans with Disabilities Act, please notify us at 913-768-4700 at least five working days before the seminar. The CDS hotel's facilities comply with all ADA requirements.

SPECIAL DIETS: If you have special dietary needs, please circle: Diabetic shdKo Low salt Vegetarian

CANCELLATIONS AND REFUNDS

Your registration fee can be refunded if we receive written notice before July 1, 2000. No refunds will be given after that date. However, your registration fee may be transferred to another qualifying registrant. Refund checks will be processed after Aug. 20, 2000.

Seating for all events is limited. IRES reserves the right to decline registration for late registrants due to seating limitations.

No attendance certificates will be handed out until 2 pm on final day of conference. There will be no exceptions made! Please make your travel plans accordingly. Only partial C.E. credit available for those who leave early.

**Call for more details:
913-768-4700. Or see IRES
web site: www.go-ires.org**

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spotlight on
e-commerce



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Coming in the July issue:

- √ The Do's and Don't's of Conducting a Market Conduct Exam (An Insurer's Perspective)
- √ To be Resolved: "Do We Need a Federal Homeowners Insurance Catastrophe Fund?"
- √ An Up- Close Look at the West Virginia Insurance Department
- √ Insurance Brain Teasers. . .and more!