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March 15, 2011

Commissioner Susan E. Voss
President
National Association of Insurance Commissioners
2301 McGee Street, Suite 800
Kansas City, MO 64108-2662

Dear Commissioner Voss:

The National Association of Insurance Commissioners (NAIC) Executive Committee has apparently re-opened the issue of whether agent and broker commissions should be exempted from the minimum medical loss ratio requirements created by the 2010 federal health care reform law. Although this issue was thoroughly discussed and then resolved during the extensive deliberative process that the NAIC conducted last year, I am writing to provide you with additional information about why Congress included agent and broker commissions in the medical loss ratio calculation, and how this provision helps American consumers and businesses get a better value for their health insurance premium dollars.

While I disagree with the NAIC's decision to re-visit this issue, I wholeheartedly share your appreciation for the valuable work that licensed health insurance agents and brokers do on behalf of their customers. I recognize the valuable role agents and brokers play in helping American consumers and businesses purchase health insurance. I look forward to working with state and federal regulators to make sure that agents and brokers continue to play this role in today's transitional health insurance market and in the health insurance exchanges that will begin operating in 2014. But I cannot support a proposal that would allow agents, brokers, and health insurance companies to retain the estimated \$1 billion in benefits that American consumers will receive next year thanks to the health care reform law.

The purpose of the law's minimum medical loss ratio requirements was to encourage health insurance companies to deliver health care services to their customers in a more efficient and cost-effective way. While many insurers were already delivering health care at levels that met or exceeded the law's minimum medical loss ratio targets of 80% and 85%, many others were not. I am encouraged by the fact that the new law is prompting many health insurance companies that were not meeting these targets to conduct a long-overdue review of their business operations and make changes that will result in higher-quality care and lower premiums for their customers.

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In the course of their cost and service reviews, some health insurance companies have announced reductions in the sales commissions they will pay agents and brokers who sell their products. Other companies have announced that they are changing their agent and broker fees from a percentage basis to a per-member-per-month basis. For many health insurance companies, commission payments are one of their largest non-claim, administrative expenses, and have been rapidly rising in recent years because they are linked to health care inflation.

As you know, the National Association of Health Underwriters (NAHU) and other agent and broker representatives raised concerns about these commission changes on many occasions during last year's NAIC deliberations over how the minimum medical loss ratios would be calculated. In order to protect their commissions from further reductions, agent and broker groups proposed removing their fees from the medical loss ratio formula. The final medical loss ratio regulations released by the NAIC on October 21, 2010, however, included commission costs in the formula. As I will discuss in greater detail later in this letter, the NAIC's final regulations were consistent with Congress's intent that the agent and broker payments be included in the calculation of health insurance companies' "earned premiums."

In several previous letters I have written to NAIC leaders, I praised the NAIC for the skill and fairness with which it managed the development of minimum medical loss ratio definitions last year. In the face of intense lobbying by a variety of business and consumer groups, the NAIC commissioners and staff developed regulations that balanced the business needs of the health insurance industry with the law's goal of increasing the value of the money American consumers spend on health care. No interest group got everything it wanted, but the process was fair and it established a reasonable regulatory framework for all of the health insurance industry's many players.

I am therefore surprised that the NAIC has decided to re-open the debate over minimum medical loss ratios on behalf of just one of the many interest groups that was not completely satisfied with the NAIC's final minimum medical loss regulations. On March 3, 2010, Florida Insurance Commissioner Kevin McCarty's Professional Health Insurance Advisors Task Force released draft federal legislation that would exclude agent and broker commissions from the medical loss ratio calculation. This is the same proposal that NAHU and other agent and broker groups unsuccessfully offered during the NAIC's 2010 deliberations. It is probably not a coincidence that two weeks before he released this draft, Commissioner McCarty received NAHU's "Spirit of Independence" award, which praised him for, among other things, his efforts to "exclude agent and broker commissions from the MLR [medical loss ratio] calculation."¹

The proposal offered by NAHU and Commissioner McCarty would protect the income of health insurance agents and brokers, but at the expense of millions of American consumers and businesses. Indeed, their proposal would undermine one of the key consumer-protection provisions of the health care reform law. As I discuss in more detail below, the NAHU-McCarty

¹ National Association of Health Underwriters Press Release, *NAHU Awards Insurance Commissioner a Top Honor* (online at <http://www.nahu.org/media/releases/2011/CCSpiritAward2011.pdf>) (Feb. 17, 2010).

proposal is not consistent with congressional intent, and it flouts the NAIC's own accounting standards. It would also allow the health insurance industry to retain a large portion of the billion or more dollars in premium cuts and rebates that the current law requires it to share with American consumers in early 2012. I urge you and other NAIC members to take a closer look at how this proposal will affect the consumers of your states before you endorse it.

1. When Writing the Medical Loss Ratio Legislation, Congress Relied on the NAIC's Definition of "Premiums Earned"

The purpose of the minimum medical loss ratio provision in the health care reform law was to encourage health insurance companies to spend a larger portion of their customers' premium dollars on medical care. In the individual and small group markets, the law requires health insurance companies to spend 80% of their customers' premium dollars on providing health care services or improving the quality of those services. In the large group health insurance market, the minimum medical loss ratio target is 85%. Insurers that do not meet these levels are required to pay pro rata rebates to their customers; the greater the amount the health insurance company falls below the 80% and 85% targets, the larger rebate it pays its policyholders.

This provision was developed and drafted after extensive analysis of the medical loss ratio data that health insurance companies report to state regulators and the NAIC. Both Congress and the Congressional Budget Office relied on this data to determine minimum medical loss ratio levels that fell in the middle range of the individual and group medical markets. While many companies were selling health insurance coverage that met or exceeded the 80% and 85% medical loss ratio levels, a "significant minority" of insurers were operating below these levels.² The purpose of the legislation was to give this latter group a new financial incentive to provide their customers a better value for their premium dollars. Because we relied on the NAIC's data when we developed the 80% and 85% minimum medical loss ratio levels in the health care reform law, we were also relying on the NAIC's formula for calculating the medical loss ratio. That formula is the following:

$$\text{Medical Loss Ratio} = \frac{\text{Incurred Claims} + \text{Change in Contract Reserves}}{\text{Premiums Earned}.^3}$$

In the NAIC formula, "Premiums Earned" includes any and all payments a health insurance company makes to an agent or broker involved in the sale of the policy. The portion of the consumer's premium dollar that is paid out as a commission is included in the denominator, but not in the numerator, meaning it is counted as a non-claim, "administrative"

² Congressional Budget Office, *Budgetary Treatment of Proposals to Regulate Medical Loss Ratios* (Dec. 13, 2009); Senate Committee on Commerce, Science, and Transportation, Office of Oversight and Investigations, *Implementing Health Insurance Reform: New Medical Loss Ratio Information for Policymakers and Consumers*, 111th Cong. (Apr. 15, 2010).

³ See e.g., National Association of Insurance Commissioners, *Annual Statement Blank for the Year 2008 – Health*, at Supp. 8. (Accident and Health Policy Experience Exhibit).

expense. In other words, the NAIC treats the commission as part of the health insurance company's cost of delivering health care services to its customers. The higher the payment to an agent or broker, the lower the medical loss ratio is under the NAIC formula. In the instructions it provides to regulated health insurance companies, the NAIC defines "written premium" as:

...the contractually determined amount charged by the reporting entity [the health insurance company] to the policyholder for the effective period of the contract based on the expectation of risk, policy benefits, and expenses associated with the coverage provided by the terms of the contract.⁴

The NAIC treats commission payments as an expense "associated with the coverage provided by the terms of the contract," which is consistent with the financial reporting practices of the health insurance industry. A key item in any health insurance company's financial filing is its report on "Selling, General, and Administrative" (SG&A) expenses. The "Selling" part of the SG&A expenses includes the company's marketing and distribution costs, whether those costs are incurred through direct advertising or paying third-party agents and brokers for selling their products. Health insurance industry analysts keep a careful eye on companies' SG&A expenses; lower SG&A expenses indicate that a company is being run efficiently and delivering a better value to both its customer and its shareholders.

Until a few months ago, the health insurance agents and brokers' main trade association, the National Association of Health Underwriters (NAHU), also considered commissions to be a part of a consumer's premium payment. In a glossary that is still available on www.nahu.org, NAHU defines "commission" as:

part of an insurance premium, which is paid by an insurance company to an agent or broker for procuring and servicing the business for the insurance company/client. Depending upon the size of the group being insured, these commissions average between three and ten percent of the premium paid by the employer.⁵

But after the passage of health care reform in March 2010, NAHU abruptly changed its position on the accounting of agent and broker commissions. Instead of considering commissions as one of the administrative costs that health insurance companies "load" on to consumer premiums, NAHU began arguing that agent and broker commissions are unrelated to insurers' administrative costs. According to this novel theory, the agent and broker commission was a direct payment from the consumer to the agent that merely "passed through" the health insurance company for administrative convenience.⁶ Besides being inconsistent with the NAIC and health care industry's accounting standards, my staff has not been able to locate even one

⁴ Official NAIC Annual Statement Instructions, Health, for the 2008 Reporting Year (Aug. 2008), at 63.

⁵ National Association of Health Underwriters Website, Consumer Information, Glossary of Terms (online at <http://www.nahu.org/consumer/glossary.cfm>) (accessed on Mar. 11, 2011).

⁶ Letter from Janet Trautwein, Executive Vice President and CEO, National Association of Health Underwriters to National Association of Insurance Commissioners (May 17, 2010).

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state minimum medical loss ratio law that treats commissions in the manner NAHU and Commissioner McCarty are proposing.

It is no mystery why NAHU made this 180-degree policy change. If they are counted as sales-related administrative costs, agent and broker commissions are subject to the SG&A belt-tightening many health insurance companies have been going through in order to meet the health reform law's minimum medical loss ratio targets and deliver a better value to their customers. Because in many cases, commissions represent one of insurers' largest SG&A costs, they have been one of the companies' obvious cost-cutting targets. In April 2010, barely a month after the passage of the health care reform law, Humana's CEO told investors that, due to the new minimum medical loss ratio requirements, "there is going to be pressure on commissions; there is just no question about it."⁷

Health insurance companies have repeated this message over and over since the passage of the health care reform law, both in their communications with investors and with agents and brokers who sell their products. In a recent investor teleconference, Aetna CEO Mark Bertolini commented:

While brokers have been, and will remain, key partners with Aetna, we have been consistent in our conclusion that the minimum MLR [medical loss ratio] requirements in health care reform law would and have catalyzed changes in broker compensation arrangements. Generally, our framework for creating transparency and our commission structure has been, first, where possible, to ensure transparency to allow larger customers to continue to negotiate fees directly with their broker or consultant; second, to restructure commissions so they are decoupled from annual health care inflation, improving affordability and driving future operating efficiencies; and third, to reduce the level of commissions to improve the affordability of our offerings.⁸

From the health insurance companies' perspective, the mathematical necessity of reducing high commission payments is obvious. The company cannot limit its non-claims expenditures to 20% (in order to comply with the law and avoid paying rebates) if it is paying 10% or more of every premium dollar to agents and brokers. Alan Katz, a former NAHU officer and an influential policy voice in the agent and broker community, recently walked his blog readers through the insurers' calculations:

As noted previously here, reducing broker commissions is compelled by the math of the MLR [medical loss ratio] requirements. The PPACA requires carriers to spend 20 percent of the premiums they receive from individual and small group clients on medical care and health improvement efforts... A carrier [health insurance company] with a mature block of business need 7-to-9 percent to keep the lights on, the staff paid, and other administrative costs. They look for a margin of roughly 4-to-5 percent (they may not always get it, but that's what they'll likely aim for). The remaining 6-to-9 percent

⁷ *Health Overhaul Hits Sales Commissions*, Wall Street Journal (May 18, 2010).

⁸ Aetna Inc., 4th Quarter 2010 Earnings Conference Call (Feb. 4, 2010).

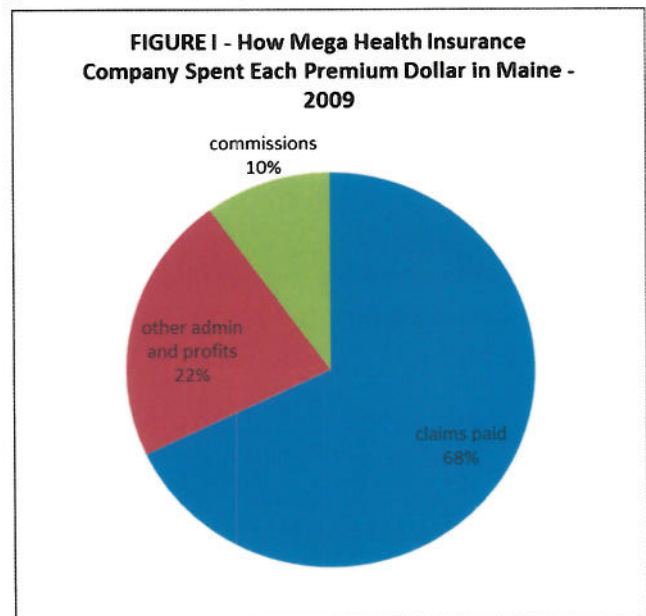
can be devoted to broker commissions. In some states this is roughly what insurers are paying their producers [agents and brokers] now; in other states, especially in the individual market, this represents a substantial pay cut.⁹

NAHU and the agents and brokers it represents are understandably unhappy that the new minimum medical loss ratio requirements are exerting downward pressure on their commission income. Their response has been to lobby legislators and insurance regulators for a special exemption that would remove their commission payments from the calculation of “earned premiums,” the number that serves as the denominator of the medical loss ratio formula. Commissioner McCarty and other insurance commissioners proposed this change at the October 2010 NAIC meeting in Orlando, and he proposed it once again on March 3, 2010, through the NAIC Executive Committee’s Professional Health Insurance Advisors Task Force. While this proposal might help some agents and brokers protect their income from slowed growth or reductions, it deprives millions of consumers and businesses from the long-overdue premium relief they are entitled to receive under the current law.

2. Excluding Agent and Broker Commissions from Medical Loss Ratio Calculations Means Fewer Rebates and Higher Premiums for American Consumers and Businesses

While NAHU has presented its proposal to the NAIC and others as a simple “administrative” fix, it would actually make an unprecedented change to the method that the NAIC and the health insurance industry use to calculate medical loss ratios. In addition, the proposal would make it more difficult for consumers and small businesses to understand how their premium dollars are being used, and it would eliminate a large portion of the more than a billion dollars in rebates and/or premium reductions consumers and small businesses could receive under the health care reform law in early 2012.

To illustrate this point, Figure I shows how the Mega Life & Health Insurance Company spent the approximately \$25 million in policyholder premium dollars the company earned in the Maine individual health insurance market in 2009.¹⁰ Although detailed data on agent and broker commissions in the individual and small group markets are not widely available, Mega was forced to disclose this information



⁹ *Tracking Commission Changes*, The Alan Katz Health Care Reform Blog, (Nov. 19, 2010) (online at <http://alankatz.wordpress.com/2010/11/19/tracking-commission-changes/>).

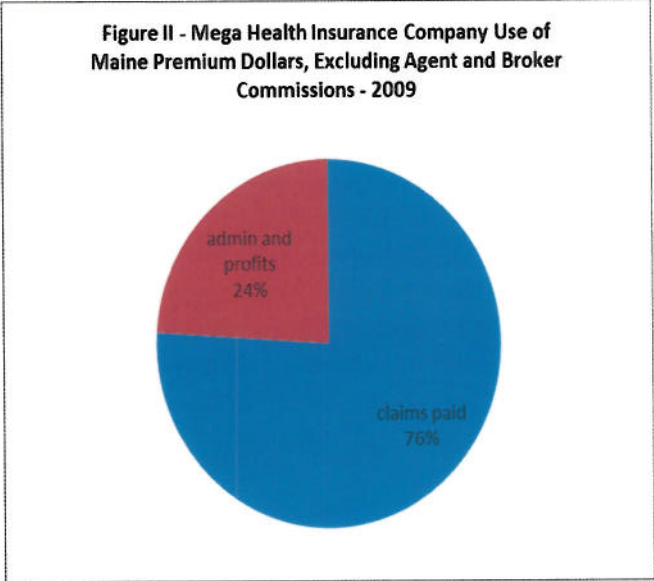
¹⁰ Maine Request for an Adjustment of the Medical Loss Ratio Standard (online at http://cciio.cms.gov/programs/marketreforms/mlr/mlr_maine.html) (accessed on Mar. 14, 2010).

during the State of Maine’s request for an individual market minimum medical loss ratio waiver from the Department of Health and Human Services (HHS). The company used 68 cents out of every dollar to pay its customers’ medical claims, and it used the remaining 32 cents for administrative costs and profit. As the figure shows, about a third of the company’s non-claims expenditures (10%) went to paying sales commissions to agents and brokers. If Mega had been subject to the health care reform law’s minimum medical loss ratio requirements in 2009, it would have owed its almost 14,000 Maine customers a \$3 million rebate (about \$218 per customer), because its claims payments fell 12 percentage points below the law’s target of 80%.

Figure II, on the other hand, shows what would have happened if the commission payments were eliminated from the calculation of “earned premium,” as proposed by NAHU and Commissioner McCarty. With the \$2.5 million of commission payments eliminated from the denominator, Mega appears to have spent 76% of every premium dollar on their patients’ medical claims, which is only 4 percentage points below the health care reform law’s 80% minimum medical loss ratio target. Under the proposed calculation method, the rebate consumers would receive goes down from \$3 million to \$1 million (or roughly \$72 per customer).¹¹ Removing commissions from the law’s definition of earned premiums allows health insurance companies and agents and brokers to pocket millions of dollars that would have been returned to consumers in the form of rebates, as Congress intended this law to do.

In addition, a calculation of the medical loss ratio that excludes commissions paid to agents and brokers gives consumers a misleading impression of how much of each premium dollar is going towards their medical care. As Figure II shows, eliminating the commission payment could lead consumers to believe that more than three-quarters of their premium dollars are going to medical care. In reality, the actual value they are getting for their premium dollars (68%) is significantly lower.

While this Maine Mega example involves transferring only \$2 million in consumer rebates back to the health insurance industry, HHS recently estimated that in 2011, the first year the minimum medical loss ratio requirements apply to the U.S. individual and group markets, health insurance companies may pay out as much as \$1.5 billion in rebates to their customers.¹² By eliminating commissions



¹¹ This analysis excludes the temporary “credibility adjustment factor” that Mega would receive under the law, which would raise the company’s medical loss ratio even closer to 80%.

¹² U.S. Department of Health and Human Services, *Health Insurance Issuers Implementing Medical Loss Ratio (MLR) Requirements Under the Patient Protection and Affordable Care Act*, 75 Fed.Reg. 230, 74864, at 74907-74909 (Dec. 1, 2010) (to be codified at 45 C.F.R. pt. 158).

from earned premiums (the denominator of the medical loss ratio formula) and thereby inflating the amount of claims paid (the numerator), NAHU's proposal would transfer a significant part of the potential \$1.5 billion pool of consumer rebate money back to the health insurance industry.

Some health care analysts have predicted that many health insurance companies will decide to avoid paying rebates by lowering their premiums. Citibank analyst Carl McDonald explained this theory in the following way:

Of course, it's highly doubtful that consumers will ever receive checks coming anywhere close to these amounts. The reason is that **plans that are currently offering products with very low loss ratios have already begun lowering premium rates** [emphasis added]. Since margins will be going down because of the minimum MLRs [medical loss ratios], many plans have concluded that a better strategy is to lower prices in order to attract more beneficiaries, with the hope that the higher volumes will help to offset some of the margin compression. So consumers are likely to receive a rebate check around June of next year, but the total rebates disbursed will likely be a lot lower than all the figures we're citing.¹³

Whether it is through cash rebates or through lower premium payments, millions of American consumers will benefit from the pressure the minimum medical loss ratio law is exerting on the health insurance industry to deliver a better value to its customers. Under the proposal advocated by NAHU and Commissioner McCarty, consumers would lose most of these benefits. The money that was intended to give consumers relief from the high cost of health care would instead be converted into additional revenue for agents, brokers, and health insurance companies.

3. Agent and Broker Commissions Significantly Benefit from Health Care Inflation

NAHU representatives repeatedly complain that the health care reform law does not do enough to restrain increases in the cost of medical care. The group fails to mention, however, that agents and brokers play a part in these increases, because their commissions are generally based on a percentage of the total premium paid by individuals or small businesses. The consequence of this payment structure is that agents and brokers earn more revenue when their clients pay higher premiums. Conversely, their income drops if medical costs decrease.

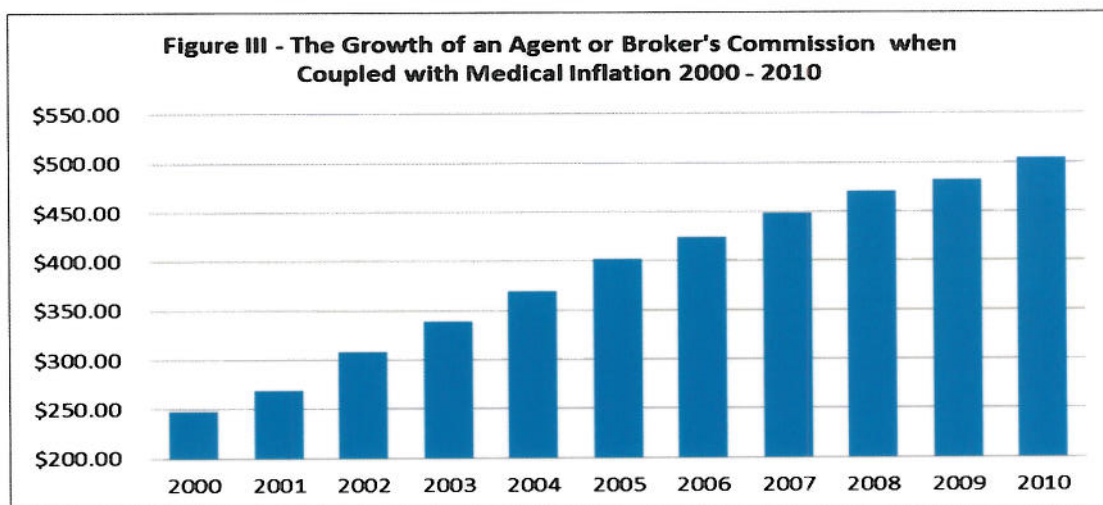
As Figure III shows, over the past decade, insurance premiums have been rising at an average annual rate of 6-7%.¹⁴ Figure III demonstrates that agent and broker commissions linked to this rate of medical inflation have roughly doubled in the past ten years. Because the

¹³ *If You Think Nature Is a Friend, Then You Sure Don't Need an Enemy: HHS Issues MLR Guidelines*, Citigroup Global Markets, Industry Overview, Managed Care (Nov. 22, 2010).

¹⁴ Figure III applies a 10% commission to the average annual premiums for individual health insurance coverage, as presented in, The Kaiser Family Foundation and Health Research & Education Trust, *Employer Health Benefits: 2010 Annual Survey* (Sep. 2, 2010). (Online at <http://ehbs.kff.org/pdf/2010/8085.pdf>)

cost of medical care has been rising much faster than the costs of other goods and services in the U.S. economy, these commission increases represent real income gains for agents and brokers paid on a percentage basis. It is important to keep these increases in mind when considering agents and brokers' concerns about reduced income. Even a reduced annual increase in income will feel like a cut to agents and brokers accustomed to increases in the 6-7% range.

Since the passage of the health care reform law in March 2010, the health insurance industry has recognized that the agent and broker commissions will have to be "decoupled" from the rate of medical inflation. As Aetna CEO Mark Bertolini explained in the investor teleconference cited above, decoupling commissions from health care inflation will both improve "affordability" and drive "future operating efficiencies."¹⁵ Even Janet Trautwein, NAHU's Executive Vice President and CEO, predicted to the Wall Street Journal last year that, "eventually there won't be any more percentage commissions."¹⁶



Instead of percentage-based commissions, more agents and brokers will receive monthly fees based on the number of customers they have enrolled with a health insurance company. Alan Katz, the former NAHU officer, recently explained the reasons for this change to the trade publication, Benefits Selling:

[Agents and brokers'] rent is not going up as fast as health insurance premiums. Therefore, since their compensation is tied to the premiums, they're getting a cost of living increase that goes beyond the cost of living...that will come to an end. Which means that commissions will be disassociated from premiums and it will be a flat fee based on the number of employees and dependents.¹⁷

¹⁵ *Supra*, note 8.

¹⁶ *Supra*, note 7.

¹⁷ *Can brokers survive health reform?*, Benefits Selling (Nov. 1, 2010) (online at <http://www.benefitsellingmag.com/Issues/2010/November-2010/Pages/Can-brokers-survive-health-reform.aspx>).

While NAHU representatives say they support restraining the increasing costs of health care, they are currently engaged in an all-out effort to exempt themselves from one of the health care reform law's most important new cost containment measures, the law's new minimum medical loss ratio requirements. The law is encouraging health insurance companies to review their administrative costs and make changes that will provide a better value at a lower cost to their customers. The proposal offered by NAHU and Commissioner McCarty to insulate sales commissions from these changes may help agents and brokers preserve their income, but it will harm the millions of American consumers who are currently paying too much money for too little health care.

4. Additional Concerns

I would like to share a few additional observations with you about NAHU's and Commissioner McCarty's proposal to exempt agent and broker commissions from the minimum medical loss ratio formula. I urge the NAIC to consider these issues before endorsing their proposal.

- **The health care reform law already gives states a way to seek relief if the medical loss ratio law is causing market disruptions.** NAHU claims that the minimum medical loss ratio law "is causing disruption in all insurance markets" and is "having a devastating financial impact" on agents, brokers, and their clients. NAHU cites this nationwide "disruption" to justify exempting their commissions from the minimum medical loss ratio calculation. The problem with this argument is that states already have a way to seek relief from the law's requirements if they are disrupting their insurance markets. HHS has already granted a waiver on this basis to one state (Maine) and is considering waiver requests from others. In its final minimum medical loss ratio rule, HHS explicitly stated that it will consider the law's impact on agents and brokers when it considers these waiver requests.¹⁸
- **The NAHU/McCarty proposal penalizes health insurance companies that are already providing high-value health care to their customers.** As noted above, the majority of health insurance companies in the individual and group markets are already providing health care at efficiency levels that meet or exceed the 80% and 85% targets set in the minimum medical loss ratio law. These companies have achieved their high ratios under the current rules that require them to count their agent and broker commissions as part of their earned premiums. Changing the rules to exempt commissions from this calculation, as NAHU and Commissioner McCarty are proposing, effectively rewards these companies' less efficient competitors.
- **The NAHU/McCarty proposal will discourage innovation in the way health insurance companies market and distribute their products.** The legislative proposal offered by NAHU and Commissioner McCarty carefully restricts the minimum medical loss ratio exemption to "licensed independent insurance producer remunerations." This

¹⁸ *Supra*, note 11, at 74877.

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provision will certainly benefit health insurance companies that have made the business decision to distribute and market their products through third-party agents and brokers, but it penalizes any company that has decided to distribute and market its products in other ways. Agent and broker commissions will not count as “administrative costs,” while all other marketing and distribution costs will. For example, it will penalize insurers that sell their products through employee sales forces or through direct marketing. It will also discourage health insurance companies from investing in innovative marketing strategies that use the Internet and social media to communicate with consumers.

Conclusion

Thanks to health care reform, tens of millions of currently uninsured Americans will be entering the health insurance market over the next few years and will be able to purchase affordable, comprehensive health care coverage. While the health insurance industry opposed health care reform and spent hundreds of millions of dollars trying to defeat it, many in the industry now acknowledge that these millions of new market entrants present an exciting new business opportunity. While profit margins on each sale in the new marketplace might be smaller, sales volumes will be higher.

I hope and fully expect that independent agents and brokers will play a crucial role in this new marketplace, and that they will benefit from these higher potential sales volumes. More than ever, individuals and small businesses will need help understanding how health insurance works, and agents and brokers are well positioned to meet this need. While federal and state policymakers should be working closely with agents and brokers to make a smooth transition to this new marketplace, we cannot and should not shield them from the important changes that are occurring – especially if it is at the expense of millions of American consumers and businesses who are already paying too much for their health insurance.

Finally, I would like to once again express my appreciation for the hard work that NAIC members and staff have done to implement the health care reform law up to this point. I will continue working with you to address and solve the problems that inevitably arise when our country takes on an issue as complicated and important as reforming our health care system. Millions of American consumers are depending on us to get it right. We cannot let them down.

Sincerely,



John D. Rockefeller IV
Chairman

cc: Kay Bailey Hutchison
Ranking Member