Right to Regulate

Amid claims the federal government should oversee insurance companies, state lawmakers say consumers are better off with them in charge.

BY HEATHER MORTON

The near-collapse and rescue of insurance giant AIG last year has renewed a long-simmering effort to switch authority for regulating the insurance industry from states to the federal government.

Proponents argue that insurance regulation is too complex for individual states to handle, and allowing the companies an option to be regulated by the federal government would streamline regulation and be good for consumers.

Opponents maintain state regulation has been effective, that the federal government could not cope with the workload, and that consumers are better off with state oversight. In fact, state regulation prevented even larger problems last year, says Maryland Senator Delores Kelley.

Heather Morton follows insurance regulation issues for NCSL.

"During the recent financial meltdown, no state-regulated insurer was found lacking in sufficient reserves or was in need of a federal bailout," she says, "including companies that are subsidiaries of AIG."

A parallel effort, supported by the Obama administration and opposed by many state lawmakers, would create a national office of insurance information that would provide a central clearinghouse for data and policy.

SENATOR
DELORES KELLEY
MARYLAND

The move toward federal legislation is "a continuation of a long-term effort to move insurance regulation to the federal government," says Tom Baker, a professor of Law and Health Sciences at the University of Pennsylvania Law School. "What is more important is how we regulate insurance rather than where we regulate insurance."

HISTORY OF STATE REGULATION

State regulation of insurance was unquestioned until 1944 when the Supreme Court decided insurance, when conducted across state lines, was interstate commerce and subject to federal regulation. Following the decision, Congress in 1945 enacted the McCarran-Ferguson Act, which reinstated state regulation of insurance. It clarified the states' power to tax insurance and limited the application of federal antitrust laws to the insurance business. The act operates as a reverse preemption; a federal law must specifically relate to insurance in order to preempt a state law.

FEDERAL CHARTER

The move toward bigger changes began with legislation in 2002 to create an optional federal charter for insurers. Legislation also has been introduced that would create a National Insurance Office within the Department of Treasury.

The optional federal charter would create a dual state and federal insurance regulatory system, similar to the system for banks and credit unions. Just as those institutions can choose to be chartered by a state or the federal government, insurance companies would make the same choice.

Numerous banking and insurance associations favor a dual system. They believe it would be good for consumers, help the United States in its global competitiveness and improve the effectiveness of the regulatory system.

The federal charter would establish a uniform, national system for insurers choosing that option, says Frank Keating, president and chief executive of the American Council of Life Insurers. "It's a reasonable measure that recognizes the national and international character of the life insurance industry and offers consumers the promise of more competition, innovative products and reduced costs."

Kevin McKechnie, executive director of the American Bankers Insurance Association, also supports the change. "We believe that truly effective insurance reform should help streamline regulators' efforts, reduce duplication, and ensure consumers the same high level of protections and recourse regardless of where they live now or in the future."

Changing the insurance regulatory system through a federal regulator would put the United States in line with other countries, making the U.S. insurance industry more competitive internationally, according to members of the Coalition for Insurance Modernization.

The insurance industry, however, is by no means united in its support for the change. Jack Friou, director of government relations for Aflac, says experience has demonstrated that the state regulatory model has been resilient even in the face of a "financial crisis meltdown."

"During this time, state insurance regulators faced an unprecedented test of their regulatory framework, function and execution," Friou says. "The result: claims were paid; consumers were protected; and insurers remain solvent. It would be unwise and imprudent for the federal government to change this regulatory structure at this time considering the long track record of this successful regulatory model."

Rhode Island Representative Brian Patrick Kennedy also cautions that the move to a new system could expose the industry to problems.

"For over 150 years, the states have done a laudable job regulating the insurance marketplace, evolving with a changing industry and protecting consumers—a top goal of regulation," Kennedy says. "Whereas we've seen problems with the federal regulation of banking, securities and the capital markets, the state-based insurance regulatory system has proved to be an island of relative calm with relatively few failures, in sharp contrast to the banking sector."

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>
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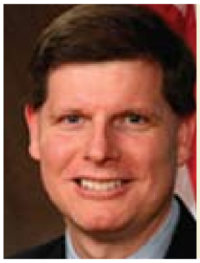
LEGISLATION PROPOSED

At the beginning of April, U.S. Representatives Melissa Bean of Illinois and Ed Royce of California introduced the National Insurance Consumer Protection Act.

"The complexity of the modern financial system of insurance conglomerates and holding companies cannot be adequately overseen by the state-based system, as shown by recent events," says Bean. "Insurance reg reform that protects consumers and investors must be included as Congress moves ahead on comprehensive reform of the financial services sector."

The bill would establish a system of regulation and supervision for nationally registered insurers, agencies, agents and brokers.



REPRESENTATIVE BRIAN PATRICK KENNEDY RHODE ISLAND

The idea is to monitor the risk to the economy from the insurance market, improve consumer protection and choice, and reduce inefficient regulatory complexity that puts U.S. firms at a competitive disadvantage.

"Never before has the federal government been so invested in an industry over which it has no regulatory authority," Royce says. "Leaving the business of insurance regulation solely to the various state insurance commissioners, while the federal government provides taxpayer-funded assistance, is simply irresponsible."

THE STATE VIEW

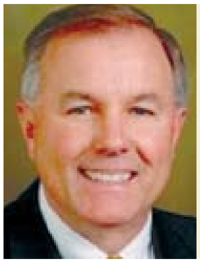
Some state lawmakers and others in the insurance industry believe insurance regulation is still best handled by the states. They argue that the insurance industry has been relatively stable because state regulators have strict reserve requirements to ensure that insurance companies have enough money to pay claims.

State legislators are particularly concerned with how consumers will be protected under federal regulation. States handle nearly a half million insurance complaints and 3 million requests for information annually. The Federal Reserve Board and the Office of the Comptroller of the Currency, in contrast, handle only abou t 130,000 complaints for the entire country.

"No insured person should be dependent upon a national 1-800 number to seek relief from unacceptable market conduct," says Maryland's Kelley.

Legislators argue state regulators are more responsive to the needs of their constituents and the need for insurance products and regulation that meet the unique demands of their state's market.

"The top priority of state insurance regulation is the protection of insurance consumers, which has been achieved by direct accountability, strong market conduct and solvency oversight," says Alabama Representative Greg Wren. "These effective safeguards con-



REPRESENTATIVE
GREG WREN
ALABAMA

tinue to protect insurance consumers when many federally chartered institutions are struggling or closing their doors."

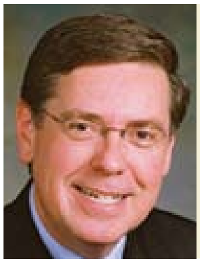
Opponents of an optional federal charter argue that it would allow insurance companies to choose the friendliest regulator with the least restrictive rules. Playing the state and federal regulators against each other would lead to "regulator shopping" and a race to the bottom in terms of regulatory regimens.

"While state legislators recognize the need for targeted financial services reform, we believe that any reform should avoid preempting successful state insurance oversight," says New York Senator James Seward. "State insurance regulation is one of the bright spots in the current otherwise bleak regulatory landscape, and should be advanced, not pared back."

Federal regulation also would put state revenues at risk and compromise the state network of insurance guaranty funds, lawmakers say. States derive $17.5 billion in taxes and fees from insurers, according to the National Association of Insurance Commissioners. Approximately 8 percent is for regulation, and the remainder supports state general funds. States could lose significant revenue and risk cutting essential services if the optional federal charter is approved.

State legislators and regulators point out that state insurance regulation is not static. State regulation improves and evolves to meet the needs of consumers and the insurance industry.

The states came together in 2002 to develop the Interstate Insurance Product Regulation Compact, which improves the efficiency and effectiveness of the way insurance products are filed, reviewed and approved. It allows consumers faster access to competitive insurance products. The compact promotes uniformity by applying national product standards with strong consumer protections, working in conjunction with the state insurance regulatory system.



SENATOR
JAMES SEWARD
NEW YORK

The compact now has 36 states as members, representing over half of the premium volume nationwide

INSURANCE INFORMATION

U.S. Representative Paul Kanjorski thinks an optional federal charter is a sound idea. But he wants a federal Office of Insurance Information within the Department of Treasury at a minimum and has introduced legislation to create one. The office would collect, analyze and share insurance data; coordinate and establish federal policy on international issues; and determine whether state insurance laws are inconsistent with federal policy in international insurance agreements.

Playing the state and federal regulators against each other would lead to "regulator shopping" and a race to the bottom.

"While most other pieces of the national economy have some sort of knowledge center within the federal government, insurance currently stands without a central office." Kanjorski says. The new office "would help Congress and the federal government make better decisions regarding national and international insurance policy."

The Obama administration backs a national insurance office, although its version differs somewhat from Kanjorski's proposal.

If a federal insurance information office is created, the National Association of Insurance Commissioners is interested in establishing a national commission to ensure uniformity and maintain consumer protection. Although still under development, the proposal would allow federal officials to preempt states that don't adopt uniform standards developed by the commission.

Rhode Island's Kennedy thinks such a commission should be of great concern to state lawmakers.

"State legislators have to remain on guard against further incursion against their ability to create laws dealing with insurance," he says. "This commission would have complete responsibility for all aspects of insurance in the United States, and would usurp the role of state legislators in the creation of insurance laws nationwide."

NATIONAL OFFICE

Although the insurance industry is split over the optional federal charter, it may find common ground on creating a national insurance office.

"If crafted properly, we could support the creation of an Office of Insurance Information as it has been previously introduced in Congress," says Charles Symington, the senior vice president for government affairs of the Independent Insurance Agents & Brokers of America. "We are optimistic that the president's plan will not be used as a precursor to federal regulation, and that this proposed [office] will be designed to work with the existing state system to protect consumers and the marketplace and ensure international coordination."

David Sampson, president and chief executive of the Property Casualty Insurers Association of America, also sees value in creating a national insurance office.

"We agree it is important to have insurance expertise at the federal level, as first proposed by Chairman Kanjorski," Sampson says "so long as fundamental regulation of insurance at the state level is preserved."

Wren of Alabama sees such a national office of insurance as a solution in search of a problem.

An "office of national insurance seeks to solve a crisis that does not exist," Wren says. "State legislators have been key to protecting insurance consumers while enacting meaningful legislation necessary to foster modernization and reforms in tandem with the nation's state insurance regulators."

Legislators will remain vigilant and enact reform as needed, he adds, "in stark contrast to the massive problems seen in the federally regulated financial services markets."