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Underwriters of D & O and Professional Liability Insurance

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***In this issue … regulation of the insurance industry again comes under scrutiny*.**

INSURANCE REGULATION IN A TIME OF CRISIS

Background

The general clamor for reform of the vast financial services industry is mostly focused on those areas directly involved with the worldwide financial crisis: banking, the mortgage industry, rating agencies, securities markets, bond markets and derivatives markets. For a helpful and largely dispassionate summary of this movement for reform, readers can refer to the January 2009 report by the U.S. Government Accountability Office (GAO). Although ostensibly objective, its title, "A Framework for Crafting and Assessing Proposals to Modernize the Outdated U.S. Financial Regulatory System," gives a good indication of its conclusions.

Because the report is almost entirely concerned with the primary participants in the crisis, had it not been for a comment letter from the American Council of Life Insurers (page 76 of the report), the issue of federal insurance regulation might not even have made it into the GAO commentary. Regulatory reform of the insurance industry clearly weighs less heavily on the minds of regulators and the general public than fixing more obvious problems. However, while state-regulated insurance entities may have had little direct impact on the financial crisis, the widespread enthusiasm for change has invigorated those who want to overhaul the current system.

State Regulation

The story of why insurance is regulated by the states is brief. In 1945 Congress enacted the McCarran-Ferguson Act that declared regulation and taxation of insurance to be subject to the laws of the individual states. The act was rushed through to counter a Supreme Court decision that held insurance to be interstate commerce and therefore subject to federal jurisdiction. The McCarran-Ferguson Act still governs modern day insurance regulation: 50 independent regulatory bodies, 50 idiosyncratic approaches and essentially no federal involvement.

The impetus for changing the regulatory status quo is not new; various organizations and politicians have for years been advocating some degree of federal oversight, most conspicuously through the call for an optional federal charter which would offer insurance companies an alternative federal regulatory system. With only a devoted few legislators inclined to shake things up, this movement had made relatively minor progress, but the severity and extent of the financial upheavals has altered the landscape.

Current Developments

Perhaps most significant is the attention that insurance regulation is getting from key political and regulatory figures. While these economic leaders are —like the GAO report— targeting the areas that caused the most problems, they are also including insurance in their public comments.

Treasury Secretary Tim Geithner in his February 10, 2009 testimony to the Senate Banking Committee, stated:

> I do believe that, as a critical part of the broad reforms, we're going to need to undertake to make sure a crisis like this does not happen again. An important part of that will be to re-examine the overall supervisory structure around insurance companies, and I think these

> proposals to have a federal charter have a lot of merit. And we'll look at them very carefully. And again, my personal view is that that could be an important part of the plan.

Similar sentiments were heard in Federal Reserve Chairman Ben Bernanke's response to questions following his February 25, 2009 testimony to the House Financial Services Committee: "To cut to the bottom line, I think that it would be a useful idea to create a federal option for insurance companies." Chairman Bernanke added that: "We did not have effective holding company supervision in some of the cases where we have had problems … so I do believe an optional federal charter would be a direction worth giving serious consideration." The federal charter movement has been given new life. The latest, more ambitious, proposed legislation could involve an Office of Federal Insurance with a physical presence in every state.

Life and Reinsurance

Federal insurance regulation has split the property and casualty sector into various industry groups with opposing positions, but the life insurance and reinsurance groups seem relatively united in their support for a federal overseer. The American Council of Life Insurers (ACLI) represents 340 member companies, which constitute 94 percent of the industry's life insurance premiums. Frank Keating, president and CEO of ACLI, was quick to praise Chairman Ben Bernanke's February 25 comments: "ACLI applauds Chairman Bernanke and we hope that Congress responds to his message."

The reinsurance market is currently lightly regulated by the states, so federal control has not aroused the same strong feelings; however members of the reinsurance community are making sure that politicians know on which side of the regulatory divide they want to fall. Franklin Nutter, president of the Reinsurance Association of America (RAA), in written testimony before the Senate Committee on Banking, Housing and Urban Affairs on March 17, 2009, said the RAA recommends that "reinsurance regulatory modernization be included in any meaningful and comprehensive financial services reform through the creation of a federal regulator having exclusive regulatory authority over the reinsurance sector."

The National Association of Insurance Commissioners (NAIC)

The organization most opposed to federal intervention is the NAIC, whose consistent historic response to federal regulation has been unambiguous opposition. Only last March NAIC President Sandy Praeger issued a statement that characterized the NAIC position: 'We agree that the federal government needs to remodel their financial regulatory house, but they need to leave the insurance room alone!"

However, pushed onto the defensive both by events of the past year and probably also by the comments of Secretary Geithner and Chairman Bernanke, the NAIC is fighting to retain its relevance and its power. Recent testimony by Therese Vaughan, the current CEO of the NAIC, indicates a reluctant acknowledgement of the new regulatory paradigm: "Any framework to regulate financial stability must integrate, but not displace, the successful state-based system of insurance regulation."

Summary

As the assault on its regulatory monopoly appears to be gathering strength, the NAIC may be forced to make unwelcome but realistic compromises that could result in life insurance and reinsurance coming under the control of the federal government through an optional charter. Such a concession might leave the NAIC better positioned to defend and maintain its oversight of the core property, casualty and personal lines. Some members of Congress are already suggesting their sympathy for such a course. In one of the more perceptive comments on the whole issue, Senator Bob Corker (R-Tenn.) said that the debate over federal versus state regulation sounds "like a family squabble within the insurance industry" before allowing that federal regulation might make sense for life insurers and reinsurers. Representative Barney Frank, the influential Chairman of the House Financial Services Committee, has also indicated support for an optional federal charter in general, and for life insurance in particular.

With legislators and regulators struggling to keep on top of the financial crisis's multiple challenges —most of which are more pressing than the "family squabble" in the insurance industry— life and reinsurance appear to be areas that might be addressed with the least conflict. Events continue to move quickly, however, and the eventual outcome remains hard to predict. ❖

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