



# Insurance Regulation: Issues, Background, and Legislation in the 111<sup>th</sup> Congress

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## Summary

The individual states have been acknowledged as the primary regulators of insurance as far back as 1868. Since the 1945 McCarran-Ferguson Act, this system has operated with the specific blessing of Congress, but has also been subject to periodic scrutiny and suggestions that the time may have come for Congress to take back the regulatory authority that it granted to the states. In the late 1980s and early 1990s, congressional scrutiny was largely driven by the increasing complexities of the insurance business and concern over whether the states were up to the task of ensuring consumer protections, particularly insurer solvency.

Prior to the recent financial crisis, congressional interest in insurance regulation focused on the inefficiencies in the state regulatory system. A major catalyst for congressional interest has been the aftermath of the Gramm-Leach-Bliley Act of 1999 (GLBA), which modernized the regulatory structure for banks and securities firms, but left the insurance sector largely untouched. Many larger insurers, and their trade associations, had previously defended state regulation but consider themselves at a competitive disadvantage in the current regulatory structure. They are now largely arguing for an optional federal charter akin to that available to banks. The increased internationalization of insurance has also brought more pressure on the current U.S. regulatory system. Various pieces of insurance regulatory reform legislation have been introduced in the current and past Congresses, including bills implementing an optional federal charter for insurance and narrower more targeted bills.

The states, particularly working through the National Association of Insurance Commissioners (NAIC), were not idle in the face of this increased scrutiny. They reacted quickly to the GLBA requirements that related to insurance agent licensing and have since embarked on a wider ranging project to modernize insurance regulation. This has included both regulatory aspects, such as streamlining the process for rate and form filing, and more basic legal aspects, such as the creation of an interstate compact to provide uniformity across states for some life insurance products. Since every state legislature must pass the legal changes suggested by the NAIC, the process typically does not move rapidly.

The large scale financial crisis, initially apparent in the sub-prime mortgage markets in 2007, has had a significant impact on the debate surrounding insurance regulatory reform. Unlike many financial crises in the past, insurers played a large role in this crisis. In particular, the failure of the large insurer American International Group (AIG) spotlighted sources of risk that had been previously unrecognized. The need for a risk regulator for the entire financial system, whether through granting enhanced powers to a currently existing regulatory body or creating a new entity, has been a common thread in many of the recent financial regulatory reform proposals. In particular, the current broad federal insurance chartering bill, H.R. 1880, includes the designation of a separate systemic risk regulator for insurers, whereas the regulatory reform proposal released by the Treasury would give enhanced systemic risk regulatory authority, including oversight over insurers, to the Federal Reserve and to a new Financial Services Oversight Council.

Although the financial crisis has changed the focus of the debate surrounding insurance regulatory reform, many of the pre-crisis pressures for regulatory changes continue. Narrower bills addressing insurance regulation and regulatory requirements have been introduced in the 111<sup>th</sup> Congress. These include H.R. 1583, H.R. 2554, H.R. 2571/S. 1363, H.R. 2609, and H.R. 3126. None of these have been considered on the floor of the House or the Senate in this Congress. This report will be updated as legislative events warrant.

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## Introduction

Insurance companies comprise a major segment of the U.S. financial services industry. Unlike banks and securities firms, however, insurance companies have been chartered and regulated solely by the states for the past 150 years. This stems from an 1868 decision of the U.S. Supreme Court<sup>1</sup> that insurance was not interstate commerce and thus was not subject to regulation by the federal government under the Commerce Clause of the U.S. Constitution. Courts followed that precedent for the next 75 years. In 1944, the U.S. Supreme Court effectively reversed its 1868 ruling and held that insurance was subject to federal oversight.<sup>2</sup> By that time, the state insurance regulatory structure was well established, and a joint effort by state regulators and insurance industry leaders to overturn the decision legislatively led to the passage of the McCarran-Ferguson Act of 1945.<sup>3</sup> That act relinquished to the states federal authority to regulate insurance, subject to “effective” insurance regulation by the states, and granted a federal antitrust exemption to the insurance industry for “the business of insurance,” which has been determined not synonymous with the “business of insurers.”<sup>4</sup>

After 1945, the jurisdictional stewardship entrusted to the states under McCarran-Ferguson was reviewed by Congress on various occasions. Some narrow exceptions to the 50-state structure of insurance regulation have been enacted such as that for some types of liability insurance in the Liability Risk Retention Act.<sup>5</sup> In general, however, when proposals were made in the past<sup>6</sup> to transfer insurance regulatory authority back to the federal government, they have been met by successful opposition from the states as well as from a united insurance industry. Such proposals for increased federal involvement usually spurred a series of regulatory reform efforts at the state level and by the National Association of Insurance Commissioners (NAIC). Such efforts were directed at correcting perceived deficiencies in state regulation and forestalling federal involvement. They were generally accompanied by pledges from state regulators to work for more uniformity and efficiency in the state regulatory process.

A major effort to transfer insurance regulatory authority to the federal government began in the mid-1980s and was spurred by insolvencies of several large insurance companies, such as Executive Life and Monarch Life. Former House Energy and Commerce Committee Chairman John Dingell, whose committee had jurisdiction over insurance at the time, questioned whether state regulation was up to the task of overseeing such a large and diversified industry. He conducted several hearings on the state regulatory structure and also proposed legislation that would have created a federal insurance regulatory agency modeled on the Securities and Exchange Commission (SEC). State insurance regulators and the insurance industry opposed his proposal and worked together to implement a series of reforms at the state level and at the NAIC, including a new state accreditation program setting baseline standards for state solvency

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<sup>1</sup> *Paul v. Virginia*, 75 U.S. (8 Wall.) 168 (1868).

<sup>2</sup> *U.S. v. South-Eastern Underwriters Association*, 322 U.S. 533 (1944).

<sup>3</sup> 15 U.S.C. Sec. 1011 *et seq.*

<sup>4</sup> See CRS Report RL33683, *Courts Narrow McCarran-Ferguson Antitrust Exemption for “Business of Insurance”:* Viability of “State Action” Doctrine as an Alternative, by Janice E. Rubin.

<sup>5</sup> 15 U.S.C. Sec. 3901 *et seq.* See CRS Report RL32176, *The Liability Risk Retention Act: Background, Issues, and Current Legislation*, by Baird Webel.

<sup>6</sup> Most such proposals prior to the 1990s focused on relatively narrow amendments to McCarran-Ferguson rather than large scale replacement of the state regulatory system.

regulation. Under those standards, to obtain and retain its accreditation, each state must have adequate statutory and administrative authority to regulate an insurer's corporate and financial affairs and the necessary resources to carry out that authority. In spite of these changes, however, another breach in the state regulatory system occurred in the late 1990s. Martin Frankel, who had previously been barred from securities dealing by the SEC, slipped through the oversight of several states' insurance regulators and looted a number of small life insurance companies of some \$200 million. Despite the embarrassment to state regulation, this did not bring long-term change to federal policy.

In the middle and latter part of the 1990s, Congress' general attention on insurance regulatory matters waned. In recent Congresses, however, attention has again focused on the regulatory structure of insurance. From the 107<sup>th</sup> through the 109<sup>th</sup> Congresses, the House Financial Services Committee in particular held more than a dozen hearings at both the subcommittee and full committee levels on insurance matters. Representative Michael Oxley, who chaired the committee during this time, indicated a strong interest in pursuing legislation to change the regulatory structure. A number of broad proposals for some form of federal chartering or other federal intervention in insurance regulation were put forward in both houses of Congress, but none were marked up or reported by the various committees of jurisdiction.

In the first session of the 110<sup>th</sup> Congress, Senators John Sununu and Tim Johnson and Representatives Melissa Bean and Edward Royce introduced the National Insurance Act of 2007 (S. 40 and H.R. 3200) into their respective chambers. While differing slightly, both bills would have created an optional federal charter and corresponding federal regulatory structure for property/casualty and life insurance. Although it stopped short of endorsing these bills, the call for an optional federal charter was echoed by the U.S. Department of the Treasury when it released a "Blueprint for a Modernized Financial Regulatory Structure" on March 31, 2008. This blueprint was for a complete reform of the entire financial regulatory system, as an intermediate step, however it also called for an optional federal charter. A number of narrower bills affecting different facets of insurance regulation and regulatory requirements were also introduced in the 110<sup>th</sup> Congress, including bills addressing surplus lines<sup>7</sup> and reinsurance, as well as insurance producer licensing.

As the 110<sup>th</sup> Congress approached its close, the financial crisis that began in 2007 reached panic proportions with the nationalization of Fannie Mae and Freddie Mac, the failure of Lehman Brothers, and the government rescue of American International Group (AIG) in September 2008. This crisis has overlaid a range of new issues and arguments to the previously existing debate on insurance regulatory reforms.

The 111<sup>th</sup> Congress has seen the introduction of insurance regulatory reform legislation to address issues raised in the crisis as well as issues predating the crisis. Legislation has included a broad federal chartering bill, the National Insurance Consumer Protection Act (H.R. 1880), as well as narrower, more focused bills, such as the Insurance Industry Competition Act of 2009 (H.R. 1583), the National Association of Registered Agents and Brokers Reform Act of 2009 (H.R. 2554), the Nonadmitted and Reinsurance Reform Act of 2009 (H.R. 2571/S. 1363), the Insurance Information Act of 2009 (H.R. 2609), and the Consumer Financial Protection Agency Act of 2009 (H.R. 3126).

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<sup>7</sup> Surplus lines insurance is insurance sold by insurance companies not licensed in the particular state where it is sold. See CRS Report RS22506, *Surplus Lines Insurance: Background and Current Legislation*, by Baird Webel.

## **Insurance and the Current Financial Crisis**

The ongoing financial crisis grew largely from sectors of the financial industry that had previously been perceived as presenting little systemic risk, including insurers. Many see the crisis as resulting from failures or holes in the financial regulatory structure, particularly a lack of oversight for the system as a whole and a lack of coordinated oversight for the largest actors in the system. This has increased the urgency in calls for overall regulatory changes, such as the implementation of increased systemic risk regulation and federal oversight of insurance, particularly larger insurance firms. The generally good performance of insurers in the crisis, however, has also provided additional arguments for those seeking to retain the state-based insurance system.

Although insurers in general appear to have weathered the financial crisis reasonably well so far, the insurance industry has seen two significant failures, one general and one specific. The first failure was spread across the financial guarantee or monoline bond insurers. Before the crisis, there were only about a dozen bond insurers in total, with four large insurers dominating the business. This type of insurance originated in the 1970s to cover municipal bonds but the insurers expanded their businesses since the 1990s to include significant amounts of mortgage-backed securities. In late 2007 and early 2008, strains began to appear due to exposure to mortgage-backed securities. Ultimately some smaller bond insurers failed and the larger insurers saw their previously triple-A ratings cut significantly. These downgrades rippled throughout the municipal bond markets, causing unexpected difficulties for both individual investors and municipalities who might have thought they were relatively insulated from problems stemming from rising mortgage defaults.

The second failure in the insurance industry was that of a specific company, AIG.<sup>8</sup> AIG had been a global giant of the industry, but it essentially failed in mid-September 2008. To prevent bankruptcy in September and October 2008, AIG was forced to seek more than \$100 billion in assistance from, and give 79.9% of the equity in the company to, the Federal Reserve. Multiple restructurings of the assistance have followed, including up to \$70 billion through the U.S. Treasury's Troubled Asset Relief Program (TARP). AIG is currently in the process of selling off parts of its business to pay back assistance that it has received from the government; how much value will be left in the 79.9% government stake in the company at the end of the process remains an open question.

The near collapse of the bond insurers and AIG could be construed as regulatory failures. One of the responsibilities of an insurance regulator is to make sure the insurer remains solvent and is able to pay its claims. Because the states are the primary insurance regulators, some may go further and argue that these cases specifically demonstrate the need for increased federal involvement in insurance. The case of AIG, however, is a complicated one. Although AIG was primarily made up of state-chartered insurance subsidiaries, at the holding company level it was a federally regulated thrift holding company and thus overseen by the Office of Thrift Supervision (OTS). The immediate losses that caused AIG's failure came from both derivatives operations overseen by OTS and from securities lending operations that originated with securities from state-chartered insurance companies. OTS has claimed it had sufficient regulatory authority and competence to oversee a complicated holding company such as AIG. Others, particularly the

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<sup>8</sup> See CRS Report R40438, *Ongoing Government Assistance for American International Group (AIG)*, by Baird Webel.

Federal Reserve, have disputed this claim and argue that a single body is needed to oversee systemic risk and large financial holding companies.

## **Pre-Crisis Factors Promoting Change**

Prior to the financial crisis, three interrelated factors had provided impetus for broad change in the insurance regulatory system. These were (1) previous legislation that revamped regulation for the banking and securities industries; (2) changes in the insurance marketplace; and (3) regulatory changes abroad. Taken together, these changes continue to have a significant impact on the competitive position of companies both within the insurance industry and between insurers and other financial service companies. Largely because of this impact, significant portions of the insurance industry, which had previously supported the state regulatory system, are now calling for federal intervention.

### **The Gramm-Leach-Bliley Act<sup>9</sup>**

In 1999, Congress passed the Gramm-Leach-Bliley Act (GLBA), instituting a massive overhaul of the federal laws governing U.S. financial institutions. Support for the measure came largely as a result of changes in market forces, frequently referred to as “convergence.” Convergence in the financial services context refers to the breakdown of distinctions separating different types of financial products and services, as well as the providers of once separate products. Drivers of such convergence are generally considered to be market forces such as globalization, new technology, e-commerce, deregulation, market liberalization, increased competition, tighter profit margins, and the growing number of sophisticated consumers. The goals behind these driving forces, in turn, appear to be the increasing efforts of all financial services providers to find growth, gain market share, create new revenue streams, and enter new markets. For example, U.S. banks have looked to adjunct non-banking products such as insurance and pension products to increase their profitability, pointing to European “bancassurers” that generate 20% to 30% of their profits from the sale of insurance and investment products integrated into core retail banking businesses.

GLBA repealed federal laws that seemed inconsistent with the way that financial services products were actually being delivered, and removed many barriers that kept banks or securities firms from competing with insurance companies. The result was the creation of a new competitive paradigm in which insurance companies now find themselves in direct competition with brokerages, mutual funds, and commercial banks. GLBA did not, however, change the basic regulatory structure for insurance or other financial products. Instead, it reaffirmed the McCarran-Ferguson Act, recognizing state insurance regulators as the “functional” regulators of insurance products and those who sell them. Some insurance companies believe that in this environment, state regulation places them at a competitive marketplace disadvantage. They maintain that their non-insurer competitors in certain lines of products have far more efficient federally based systems of regulation, while they remain subject to the perceived inefficiencies of state insurance regulation, such as the regulation of rates and forms as well as other delays in getting their products to market. For example, life insurers with products aimed at retirement and asset accumulation must now compete with similar bank products. Banks can roll out such new

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<sup>9</sup> P.L. 106-102, 113 Stat. 1338.

products nationwide in a matter of weeks, while some insurers maintain that it can take as long as two years to obtain all the necessary state approvals for a similar national insurance product launch.

GLBA also addressed the issue of modernizing state laws dealing with the licensing of insurance agents and brokers and made provision for a federally backed licensing association, the National Association of Registered Agents and Brokers (NARAB), which would have come into existence three years after the date of enactment if at least 29 states failed to enact the necessary legislation for state uniformity or reciprocity. Following GLBA, the requisite number of states enacted this legislation, and thus the NARAB provisions never came into effect. The issue of insurance producer licensing reciprocity or uniformity continued, however, as some saw and continue to see problems in the actions taken by the individual states. Every state has not passed legislation implementing reciprocity and, even in those states that did, it has not always been implemented as smoothly as desired, particularly by the agents and brokers themselves.<sup>10</sup>

## **The Market after the Gramm-Leach-Bliley Act**

Congress passed the Gramm-Leach-Bliley Act to enhance competition among financial services providers. Though many observers expected banks and insurers to converge as institutions after it passed, this has not occurred as expected. In fact, the major merger between a large bank, Citibank, and a large insurer, Travelers, which actually spurred the passage of GLBA, has effectively been undone. The corporation that resulted from the merger, Citigroup, has divested itself of almost all of its insurance subsidiaries. The property/casualty divisions were sold first, to the St. Paul's Companies, and the large majority of the life insurance operations were sold to Metlife. The only remaining sizeable bank-insurer merger is Chase Insurance, which is a part of JPMorgan Chase.<sup>11</sup>

Although large bank-insurer mergers have not occurred as expected, significant convergence has continued. Instead of merging across sectoral lines, banks began distributing—but not “manufacturing”—insurance, and insurers began creating products that closely resembled financing. Consolidation has also continued within each sector, as banks merged with banks and insurers with insurers. Also, although Congress had instituted “functional regulation” in GLBA, regulation since has still tended to track institutional lines.<sup>12</sup>

## **International Developments**

Although banking, insurance and other financial services are not an industry that produces a tangible good to be shipped across borders, the trade in such services makes up a large amount of

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<sup>10</sup> See, for example, the April 16, 2008 testimony by Tom Minkler on behalf of the Independent Insurance Agents and Brokers made before the House Financial Services Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises at [http://www.house.gov/apps/list/hearing/financialsvcs\\_dem/minkler041608.pdf](http://www.house.gov/apps/list/hearing/financialsvcs_dem/minkler041608.pdf).

<sup>11</sup> In 2003, Bank One acquired Zurich Life, and then in 2004, Bank One merged into JPMorgan Chase, and the insurance divisions were renamed.

<sup>12</sup> See CRS Report RS21827, *Insurance Regulation After the Gramm-Leach-Bliley Act*, by Carolyn Cobb. Functional regulation would entail, for example, insurance regulators overseeing insurance products being offered by banks, while banking regulators would oversee banking products offered by insurers. Institutional regulation tends to focus more on the charter of the institution so, for example, banking regulators oversee all the activities of a bank even if the bank is offering insurance products.



international trade. The United States has generally enjoyed a surplus in trade in financial services, other than insurance, but in insurance services the United States has consistently run a deficit with the rest of the world.<sup>13</sup> Consolidations in the insurance industry are creating larger international entities with growing market shares, particularly in the reinsurance market. Some have speculated that the growing “internationalization” of the financial services industry means governments may find it difficult to reform their regulation in isolation from other jurisdictions and international developments. The need for a single voice at the federal level to represent U.S. insurance interests on the international stage is a frequently heard argument for increased federal involvement in insurance regulation.

The European Union (EU), our biggest trading partner in insurance services, is continuing with its Financial Services Action Plan, a comprehensive program to transform the EU into a single market for financial services. The EU is putting forward an updated solvency regime for insurers—known as Solvency 2—to more closely match the capital required by regulators to the risks undertaken by insurers. It is

an ambitious proposal that will completely overhaul the way we ensure the financial soundness of our insurers. We are setting a world-leading standard that requires insurers to focus on managing all the risks they face and enables them to operate much more efficiently.<sup>14</sup>

The European Parliament passed Solvency 2 legislation in April 2009 with implementation foreseen in 2012. The EU has also adopted a reinsurance directive that creates a “single license” or “passport” for EU reinsurers, which would enable reinsurers licensed under the proposed standards in their home EU country to do business in all other EU countries without further requirements or collateral.<sup>15</sup> The reinsurance directive is seen as “a useful tool in international trade negotiations as it could help improve access for European reinsurers to foreign markets” such as the United States.<sup>16</sup>

Access to the U.S. market for insurance is a significant issue. Of particular concern have been the state regulatory requirements that reinsurance issued by alien<sup>17</sup> reinsurers must be backed by 100% collateral deposited in the United States. Alien reinsurers have asked state regulators to reduce this requirement to as low as 50% for insurers who meet particular criteria, pointing out, among other arguments, that U.S. reinsurers do not have any collateral requirements in many foreign countries and that the current regulations do not recognize when an alien reinsurer cedes some of the risk back to a U.S. reinsurer. In the past, the NAIC has declined to recommend a

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<sup>13</sup> U.S. exports of non-insurance financial services were \$60.2 billion in 2008 vs. imports of \$19.1 billion. Insurance exports in 2007 totaled \$10.8 billion vs. imports of \$42.9 billion. See the Bureau of Economic Analysis website at [http://www.bea.gov/international/bp\\_web/simple.cfm?anon=71&table\\_id=22&area\\_id=3](http://www.bea.gov/international/bp_web/simple.cfm?anon=71&table_id=22&area_id=3).

<sup>14</sup> Charlie McCreevy, European Union Internal Market and Services Commissioner, quoted in “Solvency II: EU to take global lead in insurance regulation” available at <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/07/1060&format=HTML&aged=0&language=EN&guiLanguage=en>. The general EU website on Solvency 2 is [http://ec.europa.eu/internal\\_market/insurance/solvency/index\\_en.htm](http://ec.europa.eu/internal_market/insurance/solvency/index_en.htm).

<sup>15</sup> Text of and further information about the directive is available at [http://ec.europa.eu/internal\\_market/insurance/reinsurance\\_en.htm](http://ec.europa.eu/internal_market/insurance/reinsurance_en.htm).

<sup>16</sup> European Commission, “Commission Proposes a Directive To Create a Real EU-Wide Market for Reinsurance,” *Internal Market: Financial Services: Insurance: Press Release*, <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/04/513&format=PDF&aged=1&language=EN&guiLanguage=en>.

<sup>17</sup> In the United States, the term “foreign” insurer generally denotes an insurer that is chartered in a different state; those insurers from a different country are called “alien” insurers.

collateral reduction, citing fears of unpaid claims from alien reinsurers and an inability to collect judgments in courts overseas. Recently, the NAIC has put forth draft federal legislation to create a board with the power to enforce national standards for reinsurance collateral, including the reduction of collateral for highly rated reinsurers.<sup>18</sup> In addition to the reinsurance collateral debate, the overall complexity of the regulatory system in the United States has been seen by some as a barrier to overseas companies operating in the United States.<sup>19</sup> This complexity may also end up hindering U.S. companies in the EU as it is not clear that state supervision of U.S. insurers will be sufficient to allow the same “single passport” access to all EU countries that EU insurers will enjoy.

## State Regulatory Modernization Efforts

Following the passage of GLBA, state insurance regulators working through the NAIC embarked on an ambitious regulatory modernization program. These efforts were in response to both the mounting criticisms of state insurance regulation and the recognition of the growing convergence of financial services and financial services products. In early 2000, NAIC members signed a *Statement of Intent: The Future of Insurance Regulation*, in which they pledged “to modernize insurance regulation to meet the realities of the new financial services marketplace” and “to work cooperatively with all our partners—governors, state legislators, federal officials, consumers, companies, agents and other interested parties—to facilitate and enhance this new and evolving market place as we begin the 21<sup>st</sup> Century.” New NAIC working groups were formed and charged with addressing the various changes needed to implement those provisions of GLBA requiring regulatory action such as that needed to prevent NARAB from coming into existence, and also to update and modernize state regulation in other ways not required by GLBA but needed to deter growing industry support for federal oversight. The NAIC’s new groups addressed such key issues as state privacy protections, reciprocity of state producer licensing laws, promotion of “speed to market” of new insurance products, development of state-based uniform standards for policy form filings, and other proposed improvements to state rate and form filing requirements.

According to NAIC, the states are now well underway in their efforts to modernize state regulation. In 2003, they set specific targets and an implementation schedule for their action plan (entitled: *A Reinforced Commitment: Insurance Regulatory Modernization Action Plan*).<sup>20</sup> Highlights of the NAIC efforts include the following:

- Certification of 47 states (as of September 2006) as reciprocal jurisdictions for producer licensing laws.<sup>21</sup> This is substantially more than the 29 states needed under GLBA to prevent the establishment of NARAB.
- Continued growth of the System for Electronic Rate and Form Filing, intended to be a single, one-stop point of entry for insurers to file changes to rates and forms. More than 318,000 filings were made through the system in 2007, up from about

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<sup>18</sup> The NAIC proposal can be found on their website at [http://www.naic.org/committees\\_e\\_reinsurance.htm](http://www.naic.org/committees_e_reinsurance.htm).

<sup>19</sup> See, for example, p. 54 of the European Commission’s *US Barriers to Trade and Investment Report for 2007*, at [http://trade.ec.europa.eu/doclib/docs/2008/april/tradoc\\_138559.pdf.pdf](http://trade.ec.europa.eu/doclib/docs/2008/april/tradoc_138559.pdf.pdf).

<sup>20</sup> See [http://www.naic.org/topics/topic\\_regulatory\\_mod\\_plan.htm](http://www.naic.org/topics/topic_regulatory_mod_plan.htm).

<sup>21</sup> See [http://www.naic.org/urtt\\_utlr.htm](http://www.naic.org/urtt_utlr.htm).

3,700 in 2001. 20 states now require insurers to file using SERFF or other electronic means.<sup>22</sup>

- State approvals of the Interstate Insurance Product Regulation Compact. This compact is intended to provide increased regulatory uniformity and a single point of product filing for four insurance lines—life, annuities, disability income, and long-term care. It came into effect in May 2006.<sup>23</sup> Currently, 35 states<sup>24</sup> have joined the compact. Three additional states<sup>25</sup> have current legislation pending to endorse the compact.

NAIC maintains that states are better positioned than the federal government to serve the interests of U.S. insurance consumers, emphasizing that state regulators are more able to make sure that the personal interests of consumers are not lost in the arena of commercial competition. To support this position, the NAIC points out that the total budget for the state insurance departments in 2007 was nearly \$1.4 billion. In 2006, the states handled nearly 394,000 official consumer complaints and more than 2.5 million consumer inquiries regarding their policies and their treatment by insurance companies and agents. In 2006, the states employed more than 13,600 employees to handle these complaints and perform the other functions of the state insurance departments.<sup>26</sup>

In the aftermath of the financial crises, the NAIC has indicated support for federal efforts to address systemic risk, “while preserving State-based insurance regulation” according to recent testimony before the Senate. In particular, the NAIC is proposing a federal systemic risk regulator operating in cooperation with the state regulators and generally deferring to the state regulators on actions relating to an insurer’s capital, reserves or solvency. The systemic regulator’s preemptive powers “should be limited to extraordinary circumstances that present a material risk to the continued solvency of the holding company, or ‘enterprise,’ the demise of which would threaten the stability of a financial system.”<sup>27</sup>

These regulatory modernization efforts by the states have not prevented a number of Members of Congress, as well as successive presidential administrations, from putting forth federal insurance regulatory reform proposals as detailed in the following section. The insurance industry has remained split, with larger insurers and insurance producers tending to favor broader federal action and smaller insurers and insurance producers tending to support targeted reforms that would leave the state system largely intact.

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<sup>22</sup> See <http://www.serff.org>.

<sup>23</sup> See <http://www.insurancecompact.org>.

<sup>24</sup> AK, CO, GA, HI, IA, ID, IN, KS, KY, LA, MA, MD, ME, MI, MN, MO, MS, NC, NE, NH, NM, OH, OK, PA, RI, SC, TN, TX, UT, VA, VT, WA, WI, WV, and WY. Puerto Rico is also a member.

<sup>25</sup> CT, NJ, and NY.

<sup>26</sup> Statistics provided by the NAIC.

<sup>27</sup> Prepared Testimony of The Honorable Michael T. McRaith in U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, *Perspectives on Modernizing Insurance Regulation*, 111<sup>th</sup> Cong., 1<sup>st</sup> sess., March 17, 2009. Available at [http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore\\_id=9d32d178-0b51-415d-989d-8bd87d6477e0](http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=9d32d178-0b51-415d-989d-8bd87d6477e0).

## **Administration Proposals for Regulatory Reform**

### **2008 Treasury Blueprint**

In March 2008, then-Secretary of the Treasury Henry Paulson released a “Blueprint for a Modernized Financial Regulatory Structure.” Although the financial crisis had begun at that time, the Treasury blueprint was not primarily a response to the crisis, but instead an attempt to create “a more flexible, efficient and effective regulatory framework.”<sup>28</sup> A wide-ranging document, the blueprint foresaw a completely revamped regulatory structure for all financial services.

The 2008 Treasury model ultimately would have resulted in a prudential regulator overseeing the solvency of individual companies, a business conduct regulator overseeing consumer protection, and a market stability regulator overseeing risks to the entire system. As an intermediate step, it made two specific recommendations on insurance regulation. First, it called for the creation of a federal insurance regulator to oversee an optional federal charter for insurers as well as federal licensing for agents and brokers. Second, recognizing that the debate over an optional federal charter is ongoing in Congress, it recommended the creation of an “Office of Insurance Oversight” in the Department of the Treasury as an interim step. This office would be charged with two primary functions: (1) dealing with international regulatory issues, including the power to preempt inconsistent state laws, and (2) collecting information on the insurance industry and advising the Secretary of the Treasury on insurance matters.

### **President Obama’s Financial Regulatory Reform Plan**

In June 2009, the Treasury Department under Secretary Timothy Geithner released a report entitled “Financial Regulatory Reform: A New Foundation,” outlining President Obama’s plan to reform financial regulation in the United States.<sup>29</sup> Since the release of the overall plan, legislative language to implement the plan has also been released. The plan could be seen as a middle of the road approach to reforming the financial system as it does not foresee a complete revamp, but it would substantially change the financial regulatory system. Specific changes called for include explicitly introducing systemic risk oversight by the Federal Reserve, combining the Office of Comptroller of the Currency and the Office of Thrift Supervision into a single banking regulator, and creating a new Consumer Financial Protection Agency.

Although the June report states that the Administration is open to additional changes in the insurance regulatory system, the specific regulatory changes called for in the released legislative language would be focused on areas other than insurance. Most insurance products, for example, are excluded from the jurisdiction of the new federal consumer protection agency. In general, the states would continue their preeminent role in insurance regulation. Insurance regulation, however, would be specifically affected through two other aspects of the President’s plan: the regulation of large financial companies presenting systemic risk and the creation of a new Office of National Insurance within the Treasury.

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<sup>28</sup> U.S. Treasury, “Treasury Releases Blueprint for Stronger Regulatory Structure,” press release, March 31, 2008, <http://www.ustreas.gov/press/releases/hp896.htm>.

<sup>29</sup> See the U.S. Treasury website at <http://ustreas.gov/initiatives/regulatoryreform/>.

Systemic risk regulation as proposed in the legislation would be the primary responsibility of the Federal Reserve in conjunction with a new Financial Services Oversight Council made up of the heads of most of the federal financial regulators. The powers to regulate for systemic risk enumerated in the draft legislation extend to all companies in the United States engaged in financial activities. Although the draft legislation does not specifically name insurers as subject to federal systemic risk regulation, it would seem to include them under federal jurisdiction. Companies judged to be a possible threat to global or U.S. financial stability may be designated Tier 1 Financial Holding Companies and subject to stringent solvency standards and additional examinations. Such companies would also be subject to enhanced resolution authority rather than standard bankruptcy provisions. Although the draft language does make reference in some places to state functional regulatory agencies, it is unclear exactly how the Federal Reserve as regulator of the financial holding company would interact with the state regulators of the individual insurance subsidiaries. Under the current regulatory system, where there are some federally regulated holding companies that are primarily insurers, the federal regulators generally defer to the state insurance regulators. Whether this deferral would continue under the new proposed legislation may be an open question.

Although systemic risk regulation would likely apply to a relatively small number of insurers, the called-for creation of an Office of National Insurance could have a broader impact. Unlike the similarly named office in other legislation, such as H.R. 1880, President Obama's Office of National Insurance would not oversee a federal insurance charter or have direct regulatory power over insurers. Rather, this office would operate as a broad overseer and voice for insurance at the federal level, including collecting information on insurance issues, setting federal policy on insurance, representing the United States in international insurance matters, and preempting some state laws where these laws are inconsistent with international agreements. These functions are similar to those of the Office of Insurance Information to be created by H.R. 2609. The office under President Obama's plan would seem to have more authority, however, than that under H.R. 2609. For example, the Obama office would have subpoena power to require an insurer to submit information rather than on relying voluntary submissions and publicly available information.

## **Legislation in the 111<sup>th</sup> Congress**

Several pieces of legislation addressing insurance regulation or regulatory requirements have been introduced in the 111<sup>th</sup> Congress, including both broad and narrow proposals. They are listed here in chronological order.

### **The Insurance Industry Competition Act of 2009 (H.R. 1583)**

Representative Peter DeFazio and five cosponsors introduced H.R. 1583 in the House on March 18, 2009. H.R. 1583 has been referred to the House Judiciary Committee, House Financial Services Committee and House Energy and Commerce Committee. No hearings or markups have been held on the bill. Previous versions of the bill were introduced in the 110<sup>th</sup> Congress.

H.R. 1583 would abolish the current exemption from federal antitrust laws for the "business of insurance" that dates to the McCarran-Ferguson Act of 1945 and remove a prohibition on investigations of insurance companies by the Federal Trade Commission. It would not change the sections of the McCarran-Ferguson Act that give preeminence to state insurance regulators.

## **The National Insurance Consumer Protection Act (H.R. 1880)**

Representatives Melissa Bean and Edward Royce introduced H.R. 1880 in the House on April 2, 2009. The bill was referred to the House Financial Services Committee, House Judiciary Committee and House Energy and Commerce Committee. No hearings or markups have been held on this bill.

This bill would create a federal charter for the insurance industry, including insurers, insurance agencies, and independent insurance producers. The federal insurance regulatory apparatus would be an independent entity under the Department of the Treasury and would preempt most state insurance laws for nationally regulated entities. Thus, nationally licensed insurers, agencies, and producers would be able to operate in the entire United States without fulfilling the requirements of each individual 50 states' insurance laws.

H.R. 1880 would also address the issue of systemic risk by designating another entity to serve as a systemic risk regulator for insurance. The systemic risk regulator would have the power to compel systemically significant insurers to be chartered by the federal insurance regulator. Thus, although the bill shares some similarities with past optional federal charter legislation, and would allow some insurers to choose whether to obtain a federal charter, it can not be considered purely an optional federal charter bill.

## **The National Association of Registered Agents and Brokers Reform Act of 2009 (H.R. 2554)**

This bill was introduced by Representative David Scott along with 34 cosponsors on May 21, 2009. A similar bill was introduced in the 110<sup>th</sup> Congress where it passed the House but was not acted upon by the Senate. H.R. 2554 was referred to the House Committee on Financial Services and has not been acted on in the 111<sup>th</sup> Congress.

H.R. 2554 would establish a National Association of Registered Agents and Brokers (NARAB). NARAB would be a private, nonprofit corporation, whose members, once licensed as an insurance producer in a single state, would be able to operate in any other state subject only to payment of the licensing fee in that state. The NARAB member would still be subject to each state's consumer protection and market conduct regulation, but individual state laws that treated out of state insurance producers differently than in-state producers would be preempted. NARAB would be overseen by a board made up of five appointees from the insurance industry and four from the state insurance commissioners. The appointments would be made by the President and the President could dissolve the board as whole or suspend the effectiveness of any action taken by NARAB.

## **The Nonadmitted and Reinsurance Reform Act of 2009 (H.R. 2571/S. 1363)**

Representative Dennis Moore and 21 cosponsors introduced H.R. 2571 on May 21, 2009, while Senators Mel Martinez, Bill Nelson, and Mike Crapo introduced S. 1363 <http://www.congress.gov/cgi-lis/bdquery/z?d110:S.929>: on June 25, 2009. Similar legislation passed the House in both the 109<sup>th</sup> and 110<sup>th</sup> Congress but was not acted on by the Senate.

These bills would address a relatively narrow set of insurance regulatory issues. In the area of nonadmitted, or surplus lines, insurance, the bills would harmonize, and in some cases reduce, regulation and taxation of this insurance by vesting the “home state” of the insured with the sole authority to regulate and collect the taxes on a surplus lines transaction. Those taxes that would be collected may be distributed according to a future interstate compact, but absent such a compact their distribution would be up to the home state. These bills also would preempt any state laws on surplus lines eligibility that conflict with the NAIC model law and would implement “streamlined” federal standards allowing a commercial purchaser to access surplus lines insurance. For reinsurance transactions, they would vest the home state of the insurer purchasing the reinsurance with the authority over the transaction while vesting the home state of the reinsurer with the sole authority to regulate the solvency of the reinsurer.<sup>30</sup>

### **The Insurance Information Act of 2009 (H.R. 2609)**

Representative Paul Kanjorski and four cosponsors introduced H.R. 2609 on May 21, 2009. A similar bill was introduced in the 110<sup>th</sup> Congress, where it was marked up by the House Financial Services Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises. H.R. 2609 has been referred to this subcommittee but has not been acted upon in the 111<sup>th</sup> Congress.

This bill would create an “Office of Insurance Information” for non-health insurance in the Department of the Treasury. The Deputy Assistant Secretary heading this office would be charged with collecting and analyzing insurance information and establishing federal policy on international insurance issues, as well as advising the Secretary of the Treasury on major insurance policy issues. State laws or regulations that the head of the office finds to be inconsistent with the federal policy on international insurance issues would be preempted, subject to an appeal to the Secretary.

### **The Consumer Financial Protection Agency Act of 2009 (H.R. 3126)**

Representative Barney Frank and 12 cosponsors introduced H.R. 3126 on July 8, 2009. It has been referred to the House Financial Services Committee and House Energy and Commerce Committee. No hearings or markups have been held on this bill.

H.R. 3126 would create a new financial regulator focusing on consumer protection, similar to that originally proposed by the Obama Administration. This regulator, however, would cover only a small portion of insurance products, namely credit insurance, mortgage insurance, and title insurance. For these lines of insurance, the bill would not preempt state consumer protection laws that provide greater protections to consumers, but would preempt otherwise conflicting state laws. Consumer protection for other lines of insurance would remain completely under state supervision.<sup>31</sup>

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<sup>30</sup> See CRS Report RS22506, *Surplus Lines Insurance: Background and Current Legislation*, by Baird Webel.

<sup>31</sup> See CRS Report R40696, *Financial Regulatory Reform: Analysis of the Consumer Financial Protection Agency (CFPA) as Proposed by the Obama Administration and H.R. 3126*, by David H. Carpenter and Mark Jickling.

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