4. POLICY POSITION

OPPOSING CONTINUING FEDERAL INSURANCE CHARTERING EFFORTS

BACKGROUND

For several years, there have been efforts at the federal level to federalize insurance regulation, a development that requires the vigilance and attention of state policymakers. In response to these efforts, a number of organizations, including The Council of State Governments, have adopted resolutions encouraging state actions to preserve the pre-eminence of state insurance systems and educating state elected officials on the potential ramifications of a bifurcated insurance scheme (federal and state) on consumers and state revenues. Some of these federal efforts have involved legislation in 2007 that was introduced by U.S. Senators John Sununu and Tim Johnson, S.40, *The National Insurance Act of 2007*, that proposed, among other things, the creation of an independent Office of National Insurance (ONI)—housed within the U.S. Department of the Treasury—that would oversee a separate system of regulation and supervision for insurers and producers that choose to be licensed or chartered at the federal level. The 2007 legislation also allowed surplus line insurers (insurance risks that the private market does not cover) to opt for federal oversight.

While this 2007 legislation did not pass, in both 2008 and 2009, there were additional federal measures that sought to federalize insurance regulation. Specifically, in 2008, the measures took the form of the release of the U.S. Department of the Treasury publication—*Blueprint for a Modernized Financial Regulatory Structure*—which endorses an optional federal charter (OFC) for insurance regulation. An OFC would sacrifice important state consumer protections in favor of costly and untested federal bureaucracies. It would lead to a plethora of state and federal directives, potentially jeopardize state premium tax revenue, negatively impact smaller regional insurance companies, and ignore everything that states have achieved in streamlining their insurance systems. The Blueprint reported on all aspects of the U.S. financial services sector, including commercial banks and depository institutions, insurance, securities and futures, and finance companies, among others. While insurance was just a small part of the Blueprint, the report criticized state oversight and stated that "the inherent nature of a state-based regulatory system makes the process of developing national products cumbersome and more costly, directly impacting the competitiveness of U.S. insurers." Regarding insurance, the Blueprint recommendations included: creating an OFC for licensing, regulation, and supervision for insurers, reinsurers, and insurance producers; establishing an Office of National Insurance (ONI) within the Treasury to regulate federally chartered entities; and immediately, through Congress and as an interim step—establishing an Office of Insurance Oversight (OIO) within Treasury to serve as a statutory authority regarding international issues and to serve as an advisor to the Treasury secretary on policy issues.

Another 2008 measure involved the introduction of H.R. 5840, *The Insurance Information Act of 2008, which seeks to create an Office of Insurance Information (OII)*—which would be very similar to the OIO proposed by the Treasury Blueprint—within the Treasury Department. This legislation would permit the OII to preempt state insurance laws and consumer protections if it determined that they were "inconsistent" with new federal international "agreements" and lay the foundation for an inappropriate federal scheme, such as an (ONI) and/or an (OFC). The enactment of this legislation likely would lead to an unraveling of the strong consumer protections currently embedded in the state-based insurance regulation system. As well as leading toward an OFC, an OII could compromise state systems relating to insurer solvency, reserving requirements, guaranty funds, and other insurance practices that draw on the unique characteristics and needs of the individual states. The movement toward an OFC also threatens a major source of revenue for states—at a time when state budgets are under severe stress—since states

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secure a variety of fees, assessments and insurance premiums (estimated to be nearly $14 billion) from regulating the insurance industry. While the movement of H.R. 5840 was stymied during 2008, it likely will surface again in the future.

The final 2008 measure was the attempt by certain insurance industry representatives to link the financial disintegration beginning in the fall of 2008 of one of the world's largest financial services companies, American International Group (AIG), to the lack of a centralized federal bureaucracy that could have, ostensibly, better regulated the industry. However, AIG's financial collapse had little to do with state insurance regulation and much more to do with lax federal oversight. In fact, AIG's insurance subsidiaries, which are regulated at the state level, remain among its most attractive assets and are in sound fiscal shape as a result of the vigilance and oversight exercised by state-based insurance officials. States have regulated insurance in their individual jurisdictions prudently and diligently for more than 135 years and, therefore, this sector of the insurance market should be allowed to continue on its path of growth and prosperity. With regard to AIG's financial difficulties, these can be traced directly to AIG's Financial Products Division's risky and largely unregulated securities transactions in credit default swaps, an area subject to the regulatory oversight of the federal U.S. Office of Thrift Supervision, and one that may need greater supervision.

In 2009, additional legislation was introduced in Congress. Specifically, the *Financial Product Safety Commission Act of 2009* (S. 566 in the U.S. Senate and as H.R. 1705 in the U.S. House of Representatives) and H.R. 3126, the *Consumer Financial Protection Agency Act*, a recommendation by President Barack Obama. While S. 566/H.R. 1705 and H.R. 3126 would establish a federal Financial Product Safety Commission and a Consumer Financial Protection Agency, respectively, with authority over consumer financial products, S. 566 and H.R. 1705 as one of its objectives, intends to address predatory consumer financial products. This development could potentially expand the scope of the Financial Product Safety Commission over insurance products though importantly, H.R. 1705 does contain a provision that reaffirms the *McCarran-Ferguson Act of 1945* (this legislation, affirmed most recently by the Gramm-*Leach-Bliley Act of 1999*, established that states have sole regulatory authority for the regulation of the business of insurance) and, thus, state regulation over the business of insurance. Even though S. 566 omits such language, H.R. 3126 exempts the business of insurance—except for credit, mortgage, and title insurance—from its definition of "Financial Activity."

The Southern Legislative Conference and The Council of State Governments assert that state legislatures are more responsive to the needs of their constituents, including having a greater awareness about their need for insurance products given each state's unique market demands. Therefore, the regulation, oversight, and consumer protection of the insurance industry should be delegated to state governments, as they traditionally and historically have been accomplished under the *McCarran-Ferguson Act of 1945*. Given that state officials continue to monitor, review and regulate the banking, insurance and securities industries as it relates to their individual jurisdictions with distinction, the enactment of legislation leading to a federal insurance charter would allow companies to opt out of state insurance regulatory oversight and evade important state consumer protections.

RECOMMENDATION

The Southern Legislative Conference of The Council of State Governments urges state officials to recognize the implications of the continuing and ongoing efforts to federalize the regulation of the insurance industry. Limiting or removing the regulatory authority of state insurance officials and leaning toward federal insurance regulation not only will threaten the numerous consumer protection provisions included by different states, but it also will jeopardize a vital source of state revenue. The protection of insurance customers should continue to be based exclusively at the state level.

Furthermore, the Southern Legislative Conference of The Council of State Governments recognizes that the attempt to link the financial collapse of the American International Group (AIG) to the lack of regulation at the state level is disingenuous since the insurance lines of AIG regulated by state regulators remain among its most financially viable and attractive assets and the fact that AIG's financial problems were precipitated by the parent company's risky and largely unregulated securities transactions in credit default swaps, an area subject to the regulatory oversight of the federal U.S. Office of Thrift Supervision. A potential federal insurance office cannot by its very nature, respond, as state regulation does, to states' individual and unique insurance markets and constituent concerns along with the fact that an optional federal regulatory system would only be optional for insurers, not for consumers, taxpayers, businesses and local economies.

Therefore, the Southern Legislative Conference of The Council of State Governments recommends preserving the preeminence of state-regulated insurance systems alongside alerting and educating state officials about the continuing efforts to preempt state regulatory authority with a movement toward an optional federal charter.

Finally, the Southern Legislative Conference of The Council of State Governments requests that a copy of this policy position be forwarded to Southern state commissioners of insurance and to the Southern Congressional delegation.

Adopted by the Southern Legislative Conference, August 18, 2009, Winston-Salem, North Carolina