

## INSURANCE REGULATION: CHANGE IS URGED; THE NAIC DIGS IN

Most of those who work in insurance are too involved with daily needs of the business to pay much attention to developments in regulation. As a result many of us are sometimes surprised when the regulatory background noise suddenly becomes an Act on the statute books. Current activity in Washington is almost certain to impact the insurance industry, and this edition of **CUG.COMments** discusses what is happening.

### BACKGROUND

The McCarran-Ferguson Act of 1945 gave the states power to regulate insurance. The Act was a swift response to a Supreme Court ruling which declared insurance to be interstate commerce and therefore subject to federal control (United States v. South-Eastern Underwriters).

In just a few short paragraphs McCarran-Ferguson rebuffed the Supreme Court decision by stating that: *"The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business."*

This essentially settled the matter for about fifty years until the Gramm-Leach-Bliley Act of 1999. An important feature of Gramm-Leach-Bliley was that it allowed banks to expand into insurance, which until then had been prohibited. The Act also challenged the states to produce a uniform approach to broker licensing, thereby recognizing the inherent inefficiency of having 50 states license their own resident brokers, and then separately license all non-resident brokers doing business in their state.

Aside from the business consequences of an insur-

ance-banking combination, from a regulatory perspective it was a potentially volatile mixture. Banks had for years existed under a dual system of state and federal regulation while as noted, insurance had remained firmly under state jurisdiction. Although Gramm-Leach-Bliley acknowledged the states' continued control over insurance, as the banking industry realized the complexities of separate insurance regulation by each of the states, talk began for a dual federal-state regulatory system.

The rumblings for change that began after Gramm-Leach-Bliley have not gone away; insurance is seen by many as a financial services industry whose regulation is out of date and out of step with other financial services. In addition to federal oversight of banking, trading of the nation's stocks, bonds and other securities is controlled by the U.S. Securities and Exchange Commission.

### PRESENT EVENTS

There are two significant reform movements underway:

1. **The SMART Act**

In August 2004 the House of Representative's

Finance Services Committee's Capital Markets, Insurance and Government Sponsored Entities Subcommittee (Chairman Rep. Richard Baker) released a draft of its State Modernization and Regulatory Transparency (SMART) Act, aimed squarely at an overhaul of the insurance industry. Like Gramm-Leach-Bliley, the draft diplomatically acknowledges a continuing role for the states, but the SMART Act's very existence demonstrates a perceived need for change.

Under the proposal there are few parts of the insurance industry left untouched. Fifteen different regulatory areas are identified, including: Insurer Licensing; Producer Licensing; Life Insurance; Commercial Property and Casualty Insurance; Personal Lines; Surplus Lines; Reinsurance; Miscellaneous Insurance; Financial Surveillance (Insurer Solvency) and Creating Competitive Markets.

Perhaps the most significant provision is Title XV, the proposal for a State-National Insurance Coordination Partnership that will "promote uniformity and efficiency in government policies that affect the insurance marketplace" — clearly a federal foot-in-the-door. The drafters of the SMART Act proposals hope to introduce a bill by August 2005.

## 2. **Optional Federal Charter**

**S**imultaneous with the SMART Act has been the rise of the Optional Federal Charter movement. The broad aim of this movement is for Congress to establish an Optional Federal Charter that would give insurers and producers the choice between regulation by the states or by a federal agency, similar to the dual federal-state system that operates in banking.

The most organized push appears to be coming from a group of 135 insurers, producers and trade groups called the Optional Federal Charter Coalition. (*Editors note: Old Republic International is not part of this group.*)

The Coalition's approach has been directed to the U.S. Senate; on June 13, 2005 it sent a letter promoting the Charter to the Senate Banking Committee. Like the SMART proposal, the Coalition is at pains not to upset the state regulators: "Establishing an Optional Federal Charter would not supplant state regulation; it would simply provide an alternative to it." (*Source: Optional Federal Charter Coalition, Press Release: June 14, 2005.*) Some might say this is a little disingenuous; given the widespread dissatisfaction with the state system it is unlikely that many would find a federal system less appealing.

## **THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS (NAIC)**

**W**hat has been the response of the National Association of Insurance Commissioners? Any proposal to reduce the states' dominion over insurance may be seen as a direct challenge to this group which currently controls virtually every aspect of insurance regulation.

The NAIC reaction could be viewed as uncompromising. In a March 18 letter to Rep. Richard Baker on behalf of the NAIC, the Pennsylvania Insurance Commissioner, Diane Koken (current NAIC president) stated that, "The ...SMART Act is not a concept that the NAIC would suggest to Congress." "Our concerns," continued the NAIC president, "are deeply rooted in the basic structure of the SMART Act that mandates federal preemption of state laws and regulations, federal supervision of state regulation, and complete rate de-regulation for all states. We do not believe that tweaking the language of the SMART Act discussion draft can resolve these basic conflicts." (*Source: National Underwriter, March 28, 2005; on-line edition.*)

Any deference shown by framers of the SMART Act towards the NAIC was not, it would appear, being reciprocated. Reaction from the House Subcommittee was terse. Writing in response to the NAIC letter, Rep. Baker rejected a meeting with the

NAIC until such time as the NAIC had "proffered an alternative proposal." "Please know," wrote Rep. Baker, "that I consider myself fully apprised of the organization's thoughts on the matter, and I do not believe a meeting is required for me to further familiarize myself with your objections."

## SUMMARY

It is unlikely that the push for reform of insurance regulation by either the SMART Act or the Optional Charter adherents will be silenced by

NAIC opposition. The NAIC may come to regret its denunciation of the SMART Act discussion draft; the states owe their regulatory powers to McCarran-Ferguson, a federal Act of Congress. Presumably that which Congress gave, Congress can also take away. ❖

### Further References:

*A useful source of information on the SMART Act, the Optional Federal Charter and related documents can be found at the American Bankers Association web site:*

*[http://www.aba.com/ABIA/ABIA\\_Reg\\_Mod\\_Page.htm](http://www.aba.com/ABIA/ABIA_Reg_Mod_Page.htm)*



All past editions of CUG.COMments are available in pdf format on our web site. Go to:

<http://www.cug.com/cugcom.shtml>



## CUG DIRECTORY

### PRESIDENT . . . .

Marty Perry            312.750.8806 | mperry@cug.com

### UNDERWRITING . . . .

Tracy Burns            312.750.8977 | tburns@cug.com  
 Jim Crockett           312.750.8979 | jcrockett@cug.com  
 Clancy Foley           312.750.8960 | cfoley@cug.com  
 Frank Kastelic        312.750.8968 | fkastelic@cug.com  
 Diane Vasti            312.750.8809 | dvasti@cug.com  
 David White            312.750.8978 | dwhite@cug.com

**MAIN LINE . . . .** 312.750.8800

### CLAIMS . . . .

Vivian Y. Cohn        312.750.8807 | vcohn@cug.com  
 Mike Early            312.750.8804 | mearly@cug.com  
 Joanne Heniades     312.750.8803 | jheniades@cug.com

### MARKETING . . . .

Peter Woan            312.750.8805 | pwoan@cug.com

### ACCOUNTING . . . .

Terry Johnson        312.750.8808 | tjohnson@cug.com

**FACSIMILE . . . .** 312.750.8965

**CUG forms and applications at:**

**[www.cug.com](http://www.cug.com)**



**CHICAGO UNDERWRITING GROUP, INC.**

191 N. Wacker Drive, Suite 1000  
Chicago, Illinois 60606-1905

**ADDRESS CORRECTION REQUESTED**