

## **EDITORIAL**

### **Insurance Regulation in America – Playing Out of Its League**

**Michael R. Powers\***

*The first pitch arrived as a fastball over the middle of the plate. The batter never saw “strike one” coming.*

In October of 2004, the usually quiet world of commercial property-liability insurance was stunned by New York Attorney General Eliot Spitzer’s legal action against mega-broker Marsh, Inc. for bid-rigging and the inappropriate use of contingent commissions. With one fell swoop, the politically ambitious New York attorney general (soon to be governor, soon to be disgraced ex-governor) was able to achieve results that none of America’s state insurance regulators ever could have accomplished; and insurance regulators were left trying to look busy as they picked up the pieces.

*The second pitch was a wide curveball breaking at just the last moment. Convinced it would be outside the zone, the batter passively took “strike two.”*

In mid-September 2008, the U.S. Federal Reserve Bank announced that it was infusing \$85 billion dollars in financially troubled insurance giant American International Group (AIG). This unprecedented action was precipitated by the excessive exposure of AIG, Inc. (AIG’s holding company) to credit-default swaps involving mortgage-backed securities. Here again, state insurance regulators belatedly tried to look relevant as a crisis unfolded, with the New York Insurance Department initially approving a transfer of \$20 billion of policyholder capital to the

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parent company, apparently believing the company's finances to be salvageable just days before the federal government stepped in.

*When the third pitch is released, will our batter finally swing, or will he "go down looking"? What would you do if you were playing out of your league?*

The batter I'm talking about is America's patchwork of state insurance regulation. Unlike securities firms and banks, U.S. insurance companies and brokers are exempted from federal anti-trust laws by the McCarran-Ferguson Act. Instead, they must contend with a labyrinthine regulatory scheme in which each state (along with the District of Columbia and various territories) creates its own insurance laws, enforced by its own insurance commissioner.

This system is supported by the coordinating activities of the National Association of Insurance Commissioners (NAIC), a Kansas City-based organization to which all state regulators belong. Nevertheless, the NAIC is a nineteenth-century institution charged with handling a twenty-first-century financial-services industry. Despite its best efforts, it simply can't escape the facts that:

- All fifty-plus regulators must answer to different political constituencies, creating obvious conflicts of interest when multi-state insurance companies are confronted. (In fact, a dozen insurance regulators are elected by popular vote within their states. Imagine electing the Federal Reserve or SEC Chairman every few years!)
- The NAIC's leadership positions frequently are held by insurance commissioners from states with relatively small domestic markets (both because those commissioners are viewed as less threatening, and because they have more time to contribute). This creates natural "incongruities of interest," and the NAIC as a whole often fails to address the needs of larger, more complex markets.

Following the emergence of the AIG debacle, NAIC President (and Kansas Insurance Commissioner) Sandy Praeger issued a statement arguing that state insurance regulators are not to blame for AIG's woes because AIG's holding company is actually a non-insurance entity regulated by the federal Office of Thrift Supervision (OTS). This legalistic argument begs the question at hand. While technically true that the OTS oversees the parent company, it also is true that a federal insurance commissioner would have the political stature to go toe to toe with other federal regulators on behalf of insurance policyholders – something the NAIC can only dream of.

It is highly instructive that two major insurance-industry umbrella groups – the American Insurance Association (AIA) and the American Council of Life Insurers (ACLI) – strongly support the concept of federal insurance regulation (specifically, the “Optional Federal Charter” proposal now pending in the U.S. House and Senate). While the insurance industry historically has looked favorably on state regulation – partly because of the regulators’ sensitivity to state-specific issues and markets, and partly because of the limited oversight the industry enjoys under diffuse regulation – those benefits now have been outweighed by drawbacks of administrative inefficiency and uneven solvency supervision.

Federalizing insurance regulation should not be a partisan issue. Democrats embrace good government, and Republicans abhor bad government. Replacing America’s archaic, cumbersome, and ineffective system of state insurance regulation with a modern federal agency is a game in which nobody has to strike out.