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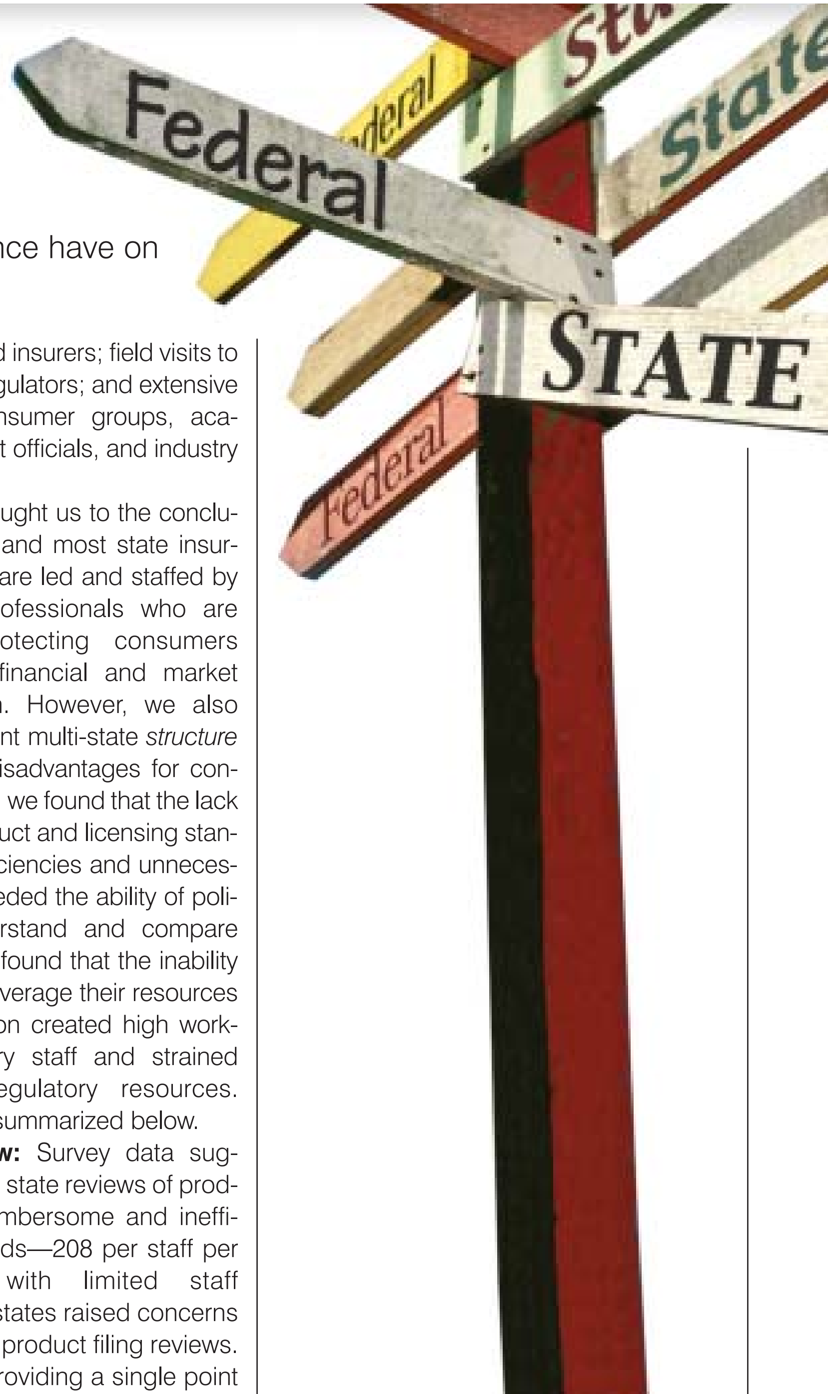
The Federal/ State Debate

What impact would federal regulation of life insurance have on consumers—and on state guaranty associations?



By Sheila C. Bair

Federal regulation of insurance is an issue of increasing national interest and concern, but it's not a new one—Congress has flirted with the idea of creating a federal insurance regulator for many years.[1] However, the issue has taken on new life and momentum thanks to the growing support for an optional federal chartering system among major insurers and uncertainties surrounding the National Association of Insurance Commissioners' (NAIC's) efforts to modernize the state-based system. Last spring, Rep. Mike Oxley (R-Ohio), chairman of the House Financial Services Committee, announced his legislative initiative to create a "roadmap" for federal involvement in insurance regulation. In July 2004, Sen. Richard Shelby (R-Ala.), chairman of the Senate Banking Committee, announced his plans to hold hearings on the state of the insurance industry that will include questions of regulatory structure.

In March 2004, the University of Massachusetts-Amherst Isenberg School of Management completed a comprehensive study of the consumer ramifications of an optional federal charter for life insurers.[2] Supported by unrestricted grants from life insurers[3] and the American Council of Life Insurers (ACLI), this year-long study sought to analyze the advantages and disadvantages for consumers of the state-based insurance regulatory system and project how they might be impacted under a federal/state system patterned after the dual system long in place for banks. The project included surveys disseminated to state insurance commissions, federal bank regulators, and insurers; field visits to state and federal regulators; and extensive interviews with consumer groups, academics, government officials, and industry representatives.

Our research brought us to the conclusion that the NAIC and most state insurance commissions are led and staffed by highly qualified professionals who are committed to protecting consumers through vigorous financial and market conduct regulation. However, we also found that the current multi-state *structure* posed significant disadvantages for consumers. Specifically, we found that the lack of uniformity in product and licensing standards created inefficiencies and unnecessary costs and impeded the ability of policyholders to understand and compare policies. We further found that the inability of states to better leverage their resources through centralization created high workloads for regulatory staff and strained smaller states' regulatory resources. These findings are summarized below.

Product Review: Survey data suggested that multiple state reviews of product filings were cumbersome and inefficient. High workloads—208 per staff per year—combined with limited staff resources in small states raised concerns about the quality of product filing reviews. We found that by providing a single point of review, a federal regulator could ease costs associated with new product development while providing greater resources to hire expert staff to review policy forms.

Many individual states had made great progress in streamlining product review. However, the average *cumulative* amount

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A Distant Mirror

One benefit of foreign travel is that it gives us a better perspective on conditions and circumstances at home. I revisited that lesson recently while participating in a London seminar on insurance insolvency practice sponsored by the International Association of Insurance Receivers (IAIR).

The United Kingdom has seen a number of large and prominent property/casualty insurance insolvencies in the past 20 years, and players in the London reinsurance and excess markets have figured prominently as creditors, debtors, and otherwise affected parties in many U.S. property/casualty insolvencies. However, during that same period the U.K. has faced virtually no life company insolvencies, and certainly none of any size or prominence.

Now, however, the U.K. is confronting some very public and prominent financial problems involving a substantial life carrier, the Equitable Life Assurance Society (ELAS). I hasten to note that ELAS is *not* related to any of the several U.S. companies that have carried similar names, all of which are, by all accounts, doing well.

ELAS is a 240-year-old mutual life insurer (by its own description the oldest mutual life insurer in the world). ELAS writes annuity and life business and now has insurance liabilities of approximately £18 billion—roughly $33 billion U.S. According to recent U.S. company rankings, the ELAS business is roughly similar in size to Sun Life Assurance Company of Canada (U.S.). And ELAS recently had to restructure certain commitments to policyholders significantly in order to bring its insurance liabilities into line with available assets.

How ELAS came to its current status is interesting, both in its own right and because of light that it sheds on the U.S. market. Space permits me now to render only a brief account of the ELAS saga, though an expanded version may appear in a future issue of the *NOLHGA Journal*. Even this abbreviated account may be clouded by differences in British and American insurance, accounting, and actuarial terminology. (As George Bernard Shaw said, England and America are two countries divided by a common language.) To those seeking a fuller account of the ELAS story, I commend the very lengthy and detailed analytical report prepared for Ruth Kelly, MP, the Financial Secretary to the Treasury (and delivered by her to the House of Commons), by the Right Honourable Lord Penrose, which can be found at *http://www.hm-treasury.gov.uk/independent_reviews/penrose_report/indrev_pen_index.cfm*. The Penrose Report is somewhat longer than *War and Peace*, though I find it a bit more readable.

Stated briefly, beginning in the 1950s, ELAS wrote a large block of annuity business that contained what subsequently proved to be very generous minimum accumulation and income benefits. By 1994, ELAS determined that the cost of providing those benefits was so great that it required ELAS, in effect, to diminish the value of the guaranties to owners of the guaranteed annuities by adopting a "differential terminal bonus policy." The adoption of this policy allowed ELAS in subsequent years to apply the resulting increased surplus to higher payments for other annuitants than ELAS otherwise would have been able to make—a practice called by some "over-bonusing."

By the late 1990s, enough questions had been raised about the validity of ELAS's differential terminal bonus policy that ELAS determined to place the propriety of that practice before the British courts in a test case.

Sitting as court of last review, the House of Lords ruled, in the July 2000 *Hyman* decision, that the ELAS differential terminal bonus policy was unlawful and that the cost of the related over-bonusing could not be reallocated only to those annuity owners who had benefited from that policy. The initial estimate of the reserve increase needed to respond to this ruling was £1.5 billion. In ensuing months, ELAS (like a number of other British life insurers) was also adversely affected by downturns in the bond and equity markets and by demands by contract owners for the return of the invested funds. In response to these serious financial pressures, ELAS took a number of dramatic steps that included putting itself up for sale, the cessation of new business writing, and significant reductions in annuitants' policy values.

The ruling by the House of Lords did not render ELAS insolvent, because policyholders of a British mutual life insurer do not have a contractual entitlement to the entirety of their policy values. Policy values include as components a guaranteed minimum—a "sum assured"—plus an amount sometimes referred to as a "bonus" (effectively a profit-sharing component) that is subject to adjustment by the insurer based on financial developments over time. The policy value reductions that followed the *Hyman* decision and subsequent pressures on ELAS did not compromise the guaranteed component of annuitants' policy values, though they did significantly decrease the bonus component. ELAS has kept policy values in line with its assets through reductions of those values

Predictably, many ELAS contract owners are now rather concerned about the burdens they are bearing (in the form of significantly reduced policy values) to keep ELAS's balance sheet in order, and developments at ELAS have been the subject of countless articles in the British and international trade and financial press. The story continues to develop. ELAS has initiated actions against certain parties, including its former auditors, directors, and management. In addition, the Parliamentary Ombudsman is reviewing the performance of the government actuaries who oversaw ELAS, and a finding of regulatory failure by the government might lead to government compensation of policyholders found to have been harmed.

ELAS now continues to operate in runoff mode in the U.K., outside of the British receivership system, and without having triggered the responsibilities of the Financial Services Compensation Scheme, a British state-run entity that operates as a "super safety net" for all manner of British financial services providers

The ELAS situation seems to yield lessons—some obvious, some subtle—for those of us interested in providing solvency protection for U.S. life insurance consumers.

One obvious lesson is that the unthinkable can happen—a large, established insurer can run into serious financial difficulties, and those difficulties can arise quickly and without a tremendous amount of advance warning. In the case of ELAS, the courts ruled, against management's expectations, that the value of commitments made to contract owners on a large block of business was much higher than what ELAS had reserved, resulting overnight in a very substantial increase in liabilities to policyholders.

Before we Americans dismiss the possibility of a similar development occurring in the United States, recall the effects on one major U.S. life company in 1999 when a rating agency decided virtually

overnight that the company's business plan (which had been in place for some time) presented enough of a disintermediation risk to warrant a sharp downgrading. That, in turn, threatened a major "run on the bank" and resulted in all manner of dislocations (though, thankfully, not the insolvency of the insurer).

Similarly, a major U.S. life insurer in 2002 faced considerable financial stress rather suddenly from the reserving impact of guaranteed benefits associated with variable annuity products. Similar financial stresses also faced a major U.S. reinsurer of such products at the same time. Again, neither case resulted in insolvency, though the life insurer ended up selling major blocks of its business in response to the pressure of the guaranties on its surplus.

Expanding somewhat the time window under consideration, we see that the record low interest rates and the bear market in equities in recent years also resulted in significant stress on U.S. life companies that had large blocks of traditional annuity business subject to minimum guaranties, either under the terms of their contracts or by application of minimum non-forfeiture laws. That problem was even worse in Japan, where a much longer period of low interest rates, coupled with years of stagnant and even deflationary economic conditions, caused the failure of a number of established life insurers. These failures resulted, at least in part, because the insurers were absorbing a "negative spread" produced by paying minimum guaranteed benefits higher than the investment returns the insurers could obtain in the credit markets.

My British IAIR hosts asked me to provide a brief overview of the largest U.S. life company insolvencies, in hopes that they might be able to distill some lessons from those cases in the event that life insolvencies increase in England, as some predict. While I was preparing that section of my remarks, I recalled how different the U.S. experience with life insolvencies has been from the property/casualty experience.

At the risk of over-generalizing, American property/casualty insurers have failed primarily because of problems on the liability sides of their balance sheets (e.g., under-reserving and adverse loss development), while major U.S. life insolvencies have been driven largely by problems on the asset sides of the balance sheets (e.g., defaults or value declines for junk bonds or real estate investments, and problems with inter-company investments).

But I wonder whether that paradigm isn't shifting. The life insurance business has changed dramatically in the past 20 or 30 years. Life insurance not long ago was a business predominantly concentrated on "vanilla" term and whole-life policies, where risk management was mostly a matter of accurately underwriting mortality and morbidity risks—a challenge, to be sure, but much less of a challenge than what property/casualty insurers have faced in predicting long-term losses on pollution, asbestos, toxic tort, and medical or product liability risks.

By contrast, today's life insurance industry focuses on a wide array of innovative financial services. That change has resulted in a "portfolio" of company liabilities, some of which are much more complex, and much harder to measure, than liabilities in respect of traditional term and whole-life policies. Stated differently, the change in the business mix for many large life companies has introduced many new challenges in measuring corporate solvency risks.

As a consequence, I suspect that major life insurance insolvencies of the future are quite as likely to stem from liability-side risks as from problems with assets. ELAS is a case where liability issues have figured prominently in that insurer's current problems. The same was true in the recent U.S. "near miss" cases I describe above and was also a major factor in the recent problems of the Japanese life industry.

The possibility of an insolvency paradigm shift does not, of course, entail a prediction that life company insolvencies will increase. The U.S. life industry remains one of the strongest sectors of the American economy, and the industry proved its resilience by coming through the recent trough in the capital markets with no major company insolvencies. But if problems do develop for one or more companies, they may not be the same types of problems previously encountered by regulators and the guaranty system. Like good generals, we should not be so preoccupied with being able to win the *last* war that we are unprepared for a new set of challenges that tomorrow may bring.

Peter G. Gallanis is president of NOLHGA.

Insolvent Texas

Accountability is the key to efficiency

By Meg Melusen & Jacqueline Rixen

In June 1999, The Statesman National Life Insurance Company—a small Texas insurer licensed in 31 states—was placed into liquidation with a preexisting liquidation plan to take care of the policies in place.[1] All assumption agreements associated with the plan were closed before the end of July that same year. The net cost to the guaranty associations as the estate approached its closing date only five years later was approximately $4.5 million.

In June 2000 things were stickier when Bankers Commercial Life Insurance Company, a Texas insurer licensed in 13 states, was placed into liquidation.[2] The estate was plagued by a significant claims backlog, poor policy records and data, and failed negotiations on an assumption reinsurance deal. Nevertheless, the issues were resolved and the estate marched forward, closing three years later with net costs to the guaranty associations of approximately $13.8 million.

What efficiencies in the Texas insurance receivership process permit relatively consistent and expedient resolutions in diverse circumstances like the ones mentioned above? Some suggest that the key lies in the unique structure of the receivership procedures in Texas. That structure includes regular reporting to the Receivership Court and active oversight by the Texas Department of Insurance (TDI), together with the combined use of a special master and special deputy receivers (SDRs). But how did these procedures come about, and why do they seem to work?

A "New" Law from 1991

It all began following a critical analysis of the insurance receivership process by state auditors in the early 1990s. As a result of the auditors' findings and recommendations, Texas legislators in 1991 passed sweeping reforms to the Texas laws controlling insurance receiverships (Code).[3] According to TDI's Counsel to Receiver James Kennedy, the new laws included three significant provisions designed to promote accountability and efficiency in the state's insurance receivership system: SDRs, oversight by TDI, and mandatory reporting.

Special Deputy Receivers: First, the legislation provided for the use of private sector individuals to be hired as SDRs to assist the commissioner in his role as receiver with the day-to-day administration of insurance receivership estates.[4] The Code requires that SDRs be selected by competitive bidding, and procedures have evolved to pre-screen potential bidders to verify their qualifications. Then, when the commissioner needs to appoint an SDR, a request for proposal is sent to the pre-qualified bidders and an SDR is ultimately selected based on a final set of criteria, including cost.

Oversight: Once appointed by the commissioner, SDRs are typically vested with all of the receiver's powers and duties; however, by law the commissioner retains oversight authority with respect to all receivership estates. Accordingly, the commissioner created the TDI's Liquidation Oversight Division (Oversight) to assist with these duties. Oversight's mission statement is "to assure the efficient liquidation of insurance company receiverships for the benefit of policyholders, receivership creditors and the taxpayers of Texas through management of the Special Deputy Receiver program and oversight of the [Texas] guaranty associations."[5] To achieve this goal, Oversight implemented performance standards for SDRs and, thanks in large part to the reporting requirements established by the 1991 law, is able to monitor the SDRs' case administration and evaluate their performance in terms of planning, execution, and cost-effectiveness.

Reporting Requirements: The third significant provision in the revised law was the imposition of a number of reporting requirements on the SDRs. Business plans (on a monthly or quarterly basis), together with

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in the Texas receivership system

monthly expense statements, must be filed with the court for each insurance receivership.

In NOLHGA's experience, the use of business plans—with goals, deadlines, and projected costs—in the course of its insolvency work has been critical to resolving issues and moving forward. In Texas, the SDRs' business plans and expense statements become a matter of public record, allowing all interested parties, including Oversight, to determine the status and progress of the receivership. Expenses, if objectionable, can be questioned by interested parties within 10 days of filing and are then approved or disallowed by Oversight, which reviews expenses to ensure they are reasonable and appropriate. The SDR's business plans must summarize the planned activities for the estate, including:

- Cost-benefit analysis information for planned activities
- Planned activity information
- Anticipated expenses of planned activities
- Estimated general administrative expenses
- A business plan variance report
- Financial statements (income statement, balance sheet, and statement of sources and uses of cash)

Receivership Special Master

With the implementation of the revised insurance receivership law, district judges in Travis County, Tex.,[6] soon felt the burden of a plethora of new responsibilities, including the duty to review the monthly status reports and approve various actions taken by the SDRs in approximately 170 existing receiverships as required under the new statute. In addition, because Travis County has a central docket system, all motions in a case are not heard by the same judge, sometimes causing inconsistent results.

To ease this burden and promote consistency, the district judges looked not to the receivership law but to the Texas Rules of Civil Procedure, which allow the appointment of a "special master" to assist the judiciary in handling matters as may be ordered by the court. Texas Rule of Civil Procedure 171 provides in pertinent part:

> The court may… appoint a [special master], who shall be a citizen of this State, and not an attorney for either party to the action, nor related to either party, who shall perform all of the duties required of him by the court, and shall be under orders of the court, and have such power as the master of chancery has in a court of equity…The order of reference to the master may specify or limit his powers, and may direct him to report only upon particular issues, or to do or perform particular acts, or to receive and report evidence only and may fix the time and place for beginning and closing the hearings, and for the filing of the master's report. Subject to the limitations and specifications stated in the order, the master has and shall exercise the power to regulate all proceedings in every hearing before him and to do all acts and take all measures necessary or proper for the efficient performance of his duties under the order. … [Upon the report and recommendation of the special master] the court may confirm, modify, correct, reject, reverse or recommit the report…The court shall award reasonable compensation to such master to be taxed as costs of suit.[7]

In 1992, Travis County district judges appointed Tom Collins as the receivership special master and referred all pending insurance receivership cases to him. Collins, a University of Texas Law School graduate with a three-year federal clerkship under his belt, had recently left his position as a litigator with a Houston bankruptcy firm to build a mediation practice in Austin. Collins has pooled all of his experience—from judicial clerk to litigator to mediator—in an effort to enhance the efficiencies and accountability of Texas's insurance receivership procedures begun by the legislature in 1991.

From the parties' perspective, the assignment of all Texas insurance receiverships to one special master is a major benefit. It "promotes continuity and consistency, and provides expertise in the complex area of receivership law," notes TDI's Kennedy.

As expected, Collins hears motions and makes recommendations to the court. But in addition, early on he implemented mandatory quarterly status conferences for all receivership estates. The status conferences keep him up-to-date on all matters referred to him and are a way for him to be accountable to the Travis County district judges. Having the statutorily required business plans before him, Collins questions parties regarding their progress, asks what they intend to accomplish before the next status conference, and requires the parties to set deadlines—and adhere to them. "I make notes," says Collins, "and they see me pull out those notes at the next conference, so they know what I'm going to ask."

Over time, Collins required the SDRs to send copies of all pleadings, monthly business plans, and statement of expenses to the guaranty associations and other creditors who request them so creditors can be informed about the receivership activities and have a meaningful opportunity to ask questions, state objections, and in some cases offer solutions.

The status conferences are held every 90 days. According to Joel Glover of the Denver-based firm Rothgerber, Johnson & Lyons, another positive aspect of the status conference is that "it creates a forum that brings the receiver and guaranty associations together every quarter." Those present at the status conferences typically include TDI representatives, SDRs, and representatives from the guaranty associations; however, the status conferences are open to all other interested parties, and on rare occasions there has hardly been enough room to seat all the creditors who attended. The status conferences are conducted in a courtroom-like setting at TDI, but they are conducted off-the-record and open discussion is encouraged. "They call me 'Tom'," explains Collins, describing the moderately informal atmosphere.

A lot of progress is made in this unique forum shepherded by a special master with expertise in the complexities of receivership law and a penchant for holding parties to the short- and long-term goals they set. Collins learns the history of the cases, the nature of the assets, the status of policies and claims, and what challenging legal issues exist. "I'm always interested in 'When do you think we can get this estate closed?'" he says. "My job is to keep the heat on…it's about not letting anything be put back in the drawer." Collins's efforts helped reduce the docket of approximately 170 receiverships in 1992 (which included ancillary receiverships, now limited under Texas law) to approximately 24 estates by 2001.

From the parties' perspective, the assignment of all Texas insurance receiverships to one special master is a major benefit. It "promotes continuity and consistency, and provides expertise in the complex area of receivership law," notes TDI's Kennedy. Bart Boles, executive director of the Texas Life, Accident, Health & Hospital Service Insurance Guaranty Association, echoes this belief: "Because the special master holds the parties accountable for timely handling of all matters from square one, issues get resolved, assets are distributed, and ultimately estates get closed very expeditiously."

The special master has proved particularly adept at encouraging parties to discuss issues and resolve disputes rather than only looking to litigation as a solution. Similarly, those who appear before him regularly know he will require them to look for workable solutions before he will get involved and hold a hearing. It doesn't take too long to learn that his first question will be "Have you talked to the other side?" when a party raises a dispute. Collins's approach to disputes has been effective in the few instances that the guaranty associations and the receiver have had different perspectives that seemed unsolvable.

In the 12 to 13 years since the legislative reform of Texas receivership law, the timeframe to close both multi-state and single-state insolvencies has been considerably reduced. Given this track record, Texas's aggressive system of accountability may serve as an example for managing the liquidation of insurance companies.

End Notes

1. Statesman National Life Insurance Company's business consisted primarily of Medicare supplement policies.
2. Bankers Commercial Life Insurance Company's business consisted primarily of Medicare supplement policies, group accident, and individual guaranteed renewable medical and surgical contracts.
3. Tex. Ins. Code Ann. Art. 21.28.
4. Previously all such work was done by TDI.
5. Texas has three guaranty associations: the Texas Life, Accident, Health & Hospital Service Insurance Guaranty Association; the Texas Property and Casualty Insurance Guaranty Association; and the Texas Title Insurance Guaranty Association.
6. By law, the exclusive jurisdiction and venue for all receiverships of insurance companies domiciled in Texas is Travis County, the seat of Texas's state government. Accordingly, Travis County District Court is where receivership actions are brought by the Texas Attorney General; it is also where suits by and against the receiver and the Texas guaranty associations are brought. See Texas Ins. Code Ann. Art. 21.28, Sec. 1(f) & 21.28, Sec. 2(i).
7. For Texas insurance receiverships, the special master's time is billed to the applicable receivership and is funded from the assets of the estates. The time billed by the receivership special master, Tom Collins, is not excessive. His average docket of status conferences has been streamlined to a total of a half-day per quarter, and he has a Written Submission Docket every Monday, where uncontested motions have been submitted for his review.

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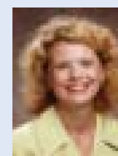

Jacqueline Rixen has owned and operated The Law Office of Jacqueline Rixen since 1998, with a brief intermission as a shareholder in another small firm. She began representing clients in insurance insolvencies in 1994 as assistant general counsel to the Texas Life, Accident, Health, and Hospital Service Insurance Guaranty Association. She has been its outside general counsel since 1998. Ms. Rixen has served as local counsel for NOLHGA and is a former member of NOLHGA's Legal Committee and Asset Recovery Task Force. She has been a speaker at numerous NOLHGA legal seminars, and she recently participated in NOLHGA's 2004 Guaranty System Legal Summit. She is a former member of the International Association of Insurance Receivers (IAIR).

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of time insurers reported for securing product approvals from states was significant: six to nine months to secure major approvals from the five largest states in which they do business. Difficulties and time delays in securing form-filing approvals inhibited the ability of life insurers to modify products in response to consumer demand and impaired competition with banks and securities firms, which do not have to undergo advance merit review of permitted product offerings.

Producer Licensing: Survey data indicated that significant progress had been made in shortening the non-resident producer licensing process. However, this had largely been achieved through reciprocity arrangements instead of the development of national, uniform standards. Insurance commissioner survey data indicated extremely high caseloads for staff assigned to review producer licensing applications—1,284 new applications per staff per year. We found that through centralized processing, uniform standards, and greater staff resources, a federal regulator would be in a better position to review producer applications and conduct multi-state background checks against national databases.

Company Licensing: Survey data also revealed significant delays in multi-state company licensing, further inhibiting the ability of smaller companies to expand operations to the competitive advantage of larger companies with pre-established multi-state infrastructures. We concluded that a federal regulator could promote competition by making it easier for smaller companies to expand. Survey data indicated that the current system imposed proportionately higher regulatory costs on small insurers.

Regulatory Costs: While we found that regulatory costs could be reduced through centralization, we also found that dollar savings per individual policyholder would be insignificant. A greater benefit for consumers would be the potential reallocation of resources to "back-end" supervisory functions, including more frequent, periodic solvency and market conduct exams along the lines of bank regulation. Our industry survey data showed that insurers were spending 65 percent of their regulatory dollars on "front-end" regulation, presumably due to the need to deal with multiple jurisdictions in company and producer licensing and product filings. Pointedly, both regulators and industry officials told us that they felt "back-end" supervisory functions were more important from a consumer protection standpoint.

We were unable to substantiate concerns that competition between federal and state insurance regulatory systems would lead to a "race to the bottom" in regulatory standards. The ability to switch between federal and state charters is seldom used among banks, and we were unable to find any instance of a bank switching charters to avoid regulatory requirements. Our historical analysis of the banking system suggested that state/federal competition had in fact contributed to efficiency and served as a check *against* lax regulation by either system.

Our research also found that because of the heightened public scrutiny given federal financial regulators and the prominence of national consumer advocacy groups, a federal insurance regulator would be well positioned to promulgate strong national standards on important consumer issues, which would create competitive pressures on the states to also "raise the bar."

In addition, we observed that the current multi-state system provides the opportunity for regulatory arbitrage among states. Several respondents to our industry survey indicated that they had set up separate subsidiaries to achieve parity with competitors domiciled in less-restrictive regulatory environments. We concluded that the current potential for "negative" regulatory competition among states is more problematic than it would be with an optional federal insurance regulator, because of the ability of insurers to domicile in small, remote states where there is less scrutiny of regulatory actions by media or consumer advocacy groups.

One important issue that our report did not examine was the nature and structure of a guaranty system under an optional federal regulatory regime. As we stated in our report:

> All proposals for an OFC contemplate that insurers would continue to participate in state guaranty mechanisms, regardless of whether they are state or federally chartered, though some proposals also provide for a federal guaranty mechanism as an alternative to state systems that do not meet minimum federal standards. The issue of insurance guaranty mechanisms in the context of federal regulation may warrant further study, including the budgetary consequences and contingent taxpayer exposure from a federal insurance guaranty.[4]

In addressing NOLHGA's 2002 Annual Meeting, Prof. Scott Harrington argued that optional federal chartering would inevitably lead to a universal federal guaranty system.[5] Though I think Prof. Harrington's arguments had merit at the time, more recent experience suggests to me a different scenario. During congressional consideration of the Terrorism Risk Insurance Act, key members of the House and Senate demonstrated strong aversion to the federal government assuming new contingent liabilities, even to provide loss compensation for acts of terrorism. No wonder. The balance sheets of government-sponsored enterprises such as Fannie Mae, Freddie Mac, and the Federal Home Loan Bank system have grown into the trillions of dollars. The Pension Benefit Guaranty Corporation is facing significant long-term shortfalls in funding. And of course, the Social Security and Medicare systems have yet to be permanently "fixed."

Though the state guaranty system for property and casualty insurers has come in for its share of criticism,[6] I have not seen evidence that the state-based guaranty system, at least for life and health insurers, has failed to do its job. Thus, given an effectively functioning state guaranty system, I think the strong likelihood is that Congress would want to preserve it as the exclusive guaranty mechanism for both federal- and state-chartered insurers. In so doing, Congress might want to authorize the federal regulator to impose minimum national standards for state guaranty associations, either directly or through a self-regulatory organization, which, for health and life insurers, would logically be NOLHGA.

Obviously, federal regulation of insurance is highly contentious, and it will take some time before consensus is reached on the

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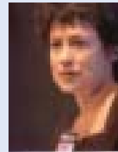
best course of action. The nature and structure of a guaranty system for federally regulated insurers will be an important part of that debate. Would states and their guaranty associations accept a role as guarantor of federally chartered insurers? Would they accept imposition of minimum federal standards? Would both state and federal regulators work together to assure high-quality solvency standards and examination processes, so crucial to minimizing the exposure of the guaranty associations? These are key questions that Congress will inevitably ask as it contemplates the role of the federal government in insurance regulation. NOLHGA will be in a unique position to provide the answers.

End Notes

1. In 1976, Sen. Edward Brooke (R-Mass.) became the first to introduce a bill to create an optional federal insurance regulator. Subsequent bills were introduced by Rep. John Dingell (D-Mich.), former Rep. John LaFalce (D-N.Y.), and Sen. Charles Schumer (D-N.Y.).
2. Bair, Sheila C. "Consumer Ramifications of an Optional Federal Charter for Life Insurers" (March 2004). Available on the Internet at *www.som.umass.edu*.
3. Insurers sponsoring the research were: MassMutual, Equitable Life, Lincoln National Life, Northwestern Mutual, Principal Financial Group, and Prudential Insurance.
4. Report, at p. 10.
5. Prof. Scott Harrington, Moore School of Business, University of South Carolina, argued this position in speaking at NOLHGA's 2002 Annual Meeting.
6. See, e.g., statement of M.R. Greenberg, Chairman and Chief Executive Officer, American International Group, before the House Committee on Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises (June 18, 2002).

About the Author

Sheila Bair is the Dean's Professor of Financial Regulatory Policy at the University of Massachusetts-Amherst Isenberg School of Management. She was formerly the Assistant Secretary for Financial Institutions at the U.S. Treasury Department. She is scheduled to speak at NOLHGA's 21st Annual Meeting, October 26–27, 2004.



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The views expressed herein are those of the authors and do not necessarily reflect those of NOLHGA or its members.

NOLHGA Calendar of Events

2004

Date	Event
September 11–14	NAIC Fall National Meeting Anchorage, Alaska
October 10–12	ACLI Annual Conference Chicago, Ill.
October 25	**MPC Meeting Las Vegas, Nev.**
October 26–27	**NOLHGA's 21st Annual Meeting Las Vegas, Nev.**
November 4–5	NCIGF/IAIR Joint Workshop San Diego, Calif.
December 4–7	NAIC Winter National Meeting New Orleans, La.

2005

Date	Event
February 23–25	**MPC Meeting Tampa, Fla.**
March 12–15	NAIC Spring National Meeting Salt Lake City, Utah
May 16–18	**MPC Meeting Austin, Tex.**
June 11–14	NAIC Summer National Meeting Boston, Mass.
September 10–13	NAIC Fall National Meeting New Orleans, La.
December 3–6	NAIC Winter National Meeting Chicago, Ill.