National Conference of Insurance Guaranty Funds NCIGF℠

Backgrounder

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On the Horizon:
Treasury Department Offers Blueprint for Modernization of Financial Regulation

By Ed Wallis

The U.S. Treasury Department released its own blueprint for a stronger regulatory structure for the U.S. financial system on March 29. That report is important for guaranty associations, though it might not seem to have been the case when the Treasury began its study with a request for comments by interested parties on October 11, 2007.

The Treasury blueprint discusses the entire area of financial regulation from depository institution, futures regulation, securities regulation and insurance regulation. It was the latter topic of insurance regulation which prompted the National Conference of Insurance Guaranty Funds (NCIGF) and the National Organization of Life & Health Insurance Guaranty Associations (NOLHGA) to jointly offer comments related to the state-based system of insurance guaranty associations to Treasury on November 21, 2007.

When the Blueprint was announced, the Treasury dove into the subject of insurance regulation making short-, intermediate- and long-term recommendations for an optimal regulatory structure. While most of the press headlines and attention was directed at recommendations regarding reform of mortgage origination practices and Federal Reserve regulation in the banking area, Treasury made several recommendations regarding insurance regulation.

Treasury proposed the immediate creation of the Federal Office of Insurance Oversight (OIO) in the Treasury Department for two purposes. First, to exercise newly granted statutory authority to deal with international regulatory issues, such as reinsurance collateral, and second to advise the Secretary of the Treasury on major domestic and international policy issues.

In addition to being the lead negotiator for the U.S. in the promotion of international insurance policy, – a role which the NAIC now carries out through one of its committees – Treasury envisions the OIO as developing expertise on issues such as financial guarantee insurance (i.e. bond insurers), private mortgage insurance and natural catastrophe insurance. Soon after the Treasury Blueprint was released, Congressman Paul Kanjorski (D-PA), who is Committee Chairman of the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises, introduced House Bill 5840 to create such an office in Treasury.

Kanjorski's bill, the Insurance Information Act of 2008, would establish the Office of Insurance Information in the Department of Treasury. While the change from "Oversight" to "Information" in the office's name is interesting, Kanjorski's bill would grant some significant powers to this office, including the authority to establish federal policy on international insurance matters and ensure that state insurance laws are consistent with agreements relating to federal policy entered into by the United States. In this context, the office's authority would extend to all lines of insurance except health insurance and it would have the power to preempt state law which is inconsistent with federal policy on international insurance matters.

Kanjorski, who as Subcommittee Chairman, may well bring this bill up for mark up and adoption by his subcommittee during this Congress before it adjourns at year's end.

More directly of interest to state guaranty associations is the Treasury position on regulation of insurance in the United States.

In its blueprint, Treasury endorsed the establishment of a federal insurance regulatory structure to provide for the creation of an optional federal charter for insurance companies in all lines of insurance. This potential has lead both NCIGF and NOLHGA to brief members of Treasury about the State Guaranty Fund system for three times during the past five years and to offer comments to Treasury last fall.

The concern shared by many in the guaranty fund system, of course, is that a regulator of federal insurance, under the new arrangement, would deliver consumer protection if a federally chartered insurer becomes insolvent.

A joint education campaign between NCIGF and NOLHGA is on the front lines of explaining why a federal guaranty system is not the ideal approach, especially given the realities that would arise if insurers are chartered by both individual states and by the federal government.

The NCIGF has urged the approach of including federally chartered insurers in the state guaranty association network by requiring any federally chartered insurer to become members of each state guaranty association where a federally chartered insurer would conduct its insurance business.

Under this concept, all insurers conducting property and casualty business within a state would be required to be members of the state's property and casualty insurance guaranty association, just as they are today. In this way, the assessment base and capacity for each guaranty association would remain intact within a state to better assure its ability to pay claims of any insurer conducting business within the state who might suffer a fatal financial failure.

The sponsors of both OFC's bills now pending in Congress, Senate Bill 40 and House Bill 3200 both agreed with the suggestion of the guaranty funds and drafted their legislation using this approach to consumer protection against the insolvency of a federally chartered insurer. So long as a state guaranty association met the qualification requirements specified in those bills, all federally chartered insurers would be required to join and maintain their membership in every state guaranty association in the states where they conducted business.

In our comments to Treasury last year, NCIGF and NOLHGA explained that the current system provides benefits to consumers in the event of insolvency in amounts equal to – and often greater than – those provided by the FDIC for bank failures. Additionally, the NCIGF and NOLHGA explained that the guaranty association protection of insurance benefits is essentially different from bank deposit insurance in the sense that the principal focus of the insurance safety net is the fulfillment of the insurance promise to the consumer, and not merely assurance of the liquidity of deposited funds.

Insurance guaranty functions require a higher level of expertise with the insurance contract and its obligations, as well as more local and direct contact with the affected insurance consumer. The NCIGF and NOLHGA explained the efficiency of the current system and its proven record of adaptability to change in the marketplace as well as future developments.

Further, the groups explained that regulatory overlap is not an issue in the current system, and would not be under their approach to the OFC concept; this is because the system provides that the guaranty association in the state where the consumer resides is exclusively for providing the specified consumer safety net protections.

The groups were heartened by the Treasury's recommendations for solvency regulation in conjunction with Treasury's proposal that Congress adopt an Optional Federal Charter approach to insurance regulation. Treasury said on page 130 of its report:

> *This approach should require federally chartered insurers to participate in qualified state guarantee funds to protect state citizens without having to create duplicative insurer-funded federally managed guarantee systems. There are benefits to retaining these funds at the state level; The state system has been tested by several previous insolvencies; reliance on the tested system eliminates the need to create an additional federal entity; and the system appears to be adaptable to companies electing a federal charter."*

Treasury's conclusion should gratify all guaranty association members who have worked so diligently for the years performing their responsibilities. Guaranty associations' achievements in protecting consumers in times of insurer financial failure demonstrate their value to society and to the financial system of this country.

While we do not expect any significant activity toward adoption of OFC legislation during the remainder of this Congress, new legislation will most likely be introduced in the next Congress commencing in 2009 when a new administration takes over in Washington and Congress reorganizes following the 2008 elections.

Proponents of OFC legislation will undoubtedly urge members of the 111th Congress to again offer OFC legislation. Treasury recommendations will certainly help state guaranty associations in making their case for adoption of the NCIGF and NOLHGA's proposal for consumer insolvency-related protection of federally chartered insurers.