"THE DEBATE ON A NATIONAL INSURANCE CHARTER"

SPEECH TO THE FIIA

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I'm not here to discuss the Schumer and La Falce bills or the AIA or ACLI proposals. I am here to review with you the fundamental question of whether the individual states or the federal government or both should or will regulate the business of insurance. But first I would like to share with you a little history on the issue.

Insurers concerned with the evolving system of state insurance regulation sponsored litigation that resulted in the 1869 Paul v Virginia US Supreme Court decision that insurance was not commerce. The interested insurers were disappointed in the decision because the result was that states were not precluded from regulating insurance. In addition, the decision made clear that the federal government had no constitutional basis to become involved in insurance regulation since all powers not specifically delegated to the federal government remained with the states. The Constitution granted the federal government authority to regulate interstate commerce but since insurance was not commerce it had no jurisdiction. The federal government could not supplant the emerging state based insurance regulatory system.

The property and casualty insurance industry that had supported federal regulation changed its position when the Sherman Antitrust Act became law in 1890. These insurers engaged in extensive price fixing schemes. Should the Sherman and later the Clayton Acts apply to insurance these activities would be illegal. This caused a shift in the industry's position from support for federal regulation to one of support for state regulation.

The industry's abuse of the public through concerted rate making and enforcement mechanisms by the property and casualty insurance industry reached the halls of congress in 1943. States had been ineffective in policing industry practices that included bribery, boycotting, shunning and coercion to enforce price uniformity. Congress held a series of hearings while a case brought by U.S. Attorney General Biddle entitled U. S. v Southeastern Underwriters was pending in federal courts. The attorney general asserted that insurance was indeed commerce and subject to both the Sherman and Clayton Antitrust Acts.

The US Supreme Court concurred with Attorney General Biddle when it rendered its June 5, 1944 decision. From that date forward state regulation has existed only by the will of Congress. The segment of the property and casualty insurance industry that engaged in concerted pricing was reluctant to give up the practice. It supported a state-

based system for the prior approval of rates to avoid the application of federal antitrust statutes. It is ironic that the very statutes that many now find so objectionable as to advocate federal regulation were enacted at their behest. Attorney General Biddle said it best when he testified before Congress "First they want federal regulation, then they want state regulation - what they really want is no regulation at all."

That was probably more than you ever wanted to know about the history of state verses federal regulation but it does point out that this is not a new issue. It's been around for over 150 years and it may well be around for a good deal longer. My purpose in this little bit of history is to bring home the point "Be careful what you wish for because you might just get it". Shortly after rate approval statutes were enacted it became clear the industry had erred in getting what it wanted. I believe the same would be true now should federal regulation become reality.

Insurers are not united in favor of an optional federal charter. The interests and problems of the life insurance industry differ from those of the property and casualty industry as do past practices. Within the property and casualty industry there is a divergence of opinion. Generally those whose roots are in the price fixing camp favor optional federal charters while those that never engaged in that activity tend to favor continuance of a state based system. The segment of the property and casualty industry that had it right in 1947 but lost to the price fixers is the same segment now opposed to federal regulation today. Is there a message here?

I oppose a dual regulatory system or a universal federal regulatory system for insurance. A federal regulatory system is not necessary to remedy state regulation's public policy shortcomings. As I see it there are four fundamental questions of public policy import. They are:

1. Our citizens are not being best served as a result of the unavailability of certain insurance products on a national basis.
2. In a few states excessive rate regulation of some lines of insurance results in a dysfunctional market.
3. State regulation may result in higher costs than federal regulation. Non-uniformity as to product contributes to higher costs. Whatever that cost it is ultimately borne by the insurance buying public.
4. State regulation is a barrier into the marketplace thus inhibiting competition.

I concede points 1. And 2., concur with the costs of non-uniformity but not regulation and do not concur with 4. The foundation of any regulatory system should be based on the public interest. To date we have heard only from special interests. We have not heard a public outcry against state regulation. In fact, what commissioners hear from the public is that they are not doing their job. The man in the street favors more not less insurance regulation. Presidential candidate Al Gore based his 1999 campaign on "The people versus the powerful". What if he would have won and a federal regulatory system were in place?

I admit state regulation is broken and in need of repair. The most important problem facing life insurers is product approval. The most important problem faced by property and casualty insurers is rate regulation. For the last three year the NAIC has worked hard on these problems. Only a handful of states have been unwilling to change but those few continue to create barriers. They have not embraced the emerging economic views of Hyack and Friedman. When President Reagan stated -"Mr. Gorbachev, tear down this wall" he was referring not only to the freedom of peoples but to the economic system in which they lived. Just as a centrally planned economy created a wall the same is true with an intrusive style of regulation. Markets become dysfunctional when rates are inadequate as a result of regulatory intervention. Federal and for the most part state regulatory agencies since the early 1980s migrated from heavy handed rate regulation to regulation that relies on competition. Some states just didn't get the message or are unwilling to accept change.

We tend to forget that the lack of uniformity in state regulation is based to a great extent as accommodation to special or local interests. An enlightened analysis of any state's insurance code could reveal these numerous exceptions. Many of these do no harm but they do create non-uniformity. Federal regulation will result in a "one-size fits all" approach. Recently, an insurance trade association called to complain that we were eliminating the requirement of surplus lines bonds. This would result in the sale of fewer bonds. We were doing so to assure that Nebraska remained reciprocal in licensing. I could not resist commenting good heartedly as to how many state surplus lines bonds member insurers would underwrite under the federal regulatory system they were advocating.

The government is best that is the closest to the people. Just as there is a bias against big business in the American psyche the same is true with big government. Both are generally viewed with suspicion. Noted Professor Samuel Huntington of Harvard University and adviser to Presidents on political and international issues stated the following: "Opposition to power and suspicion of government as the most dangerous embodiment of power are the central theme of American political thought. Power is now seen as corporate. The next challenge may be against megamonic corporate capitalism." Our citizens desire a government that is close to them and one in which they have a voice. At the federal level we have a congressman for every 535,000 people. That's hardly a voice. That is why it is important to leave to the states and local government those activities that they can undertake in a reasonable and efficient manner regardless of the wants of special interests.

President Bush announced plans for a "new federalism" in speaking to the National Governor's Association on February 26, 2001. He stated "When the history of this administration is written, it will be said the nation's governors had a faithful friend in the White House." He went on to state "The framers of the Constitution did not believe in an all-knowing, all-powerful federal government. They believed that our freedom is best preserved when power is dispersed, so let me make this pledge to you all: I'm going to make respect for federalism a priority in this administration." It will be interesting to

observe how the promoters of a dual system will fare in view of the strength of President Bush's commitment to federalism.

States have a number of strong state's rights supporters in congress. Some of those supporters are torn between their commitment to state's rights and their commitment to efficient business systems. Economic interests are promoting change at a rate that most of our citizens may be unwilling to accept. Often this promotion is without regard or even recognition of our culture, language, and historic belief systems. Technological advancements create a platform for the acceleration of change. Our political institutions are under stress and our citizens experience feelings of powerlessness and futility as their ability to influence their daily lives and destiny is called into question.

Federal regulation has been under attack particularly for the lack of efficiency. Robert Hahn, the Director of the AEI-Brookings Joint Center for Regulatory Studies recently co-authored a working paper entitled "A new Executive Order for Improving Federal Regulation? Deeper and Wider Cost-Benefit Analysis". He reported that there continues to be significant problems in federal regulatory agencies, including poor priority-setting, unintended adverse side effects, and on occasion, high costs for low benefits. The Office of Management and Budget reported that the true cost of social regulation for the year 1999 was between $146 and $229 billion dollars. It was necessary to create the Office of Information and Regulatory Affairs to oversee regulatory agency activities. For the last 20 years our presidents have issued executive orders in an attempt to quell public dissatisfaction with the federal regulatory process.

When a federal regulatory agency is charged with regulating an issue as opposed to an industry the relationship between the regulated and the regulator differs. For instance, few businesses embrace the activities of OSHA or the EPA. Yet specific industries have found comfort in their federal regulators. Professor Huntington asserted that federal regulatory agencies become a manifestation of the industries they regulate. The railroads dominated the Interstate Commerce Commission. The Civil Aeronautics Board and the Federal Aviation Administration became protectors of the airline industry. Some that advocate for federal regulation argue that the insurance industry needs such a regulatory voice in Washington.

This old premise may be changing. The federal agency responsible for energy regulation is taking heat as a result of Enron. The Securities and Exchange Commission is in the spotlight because of Enron but also due to a number of other public accounting failures. Banks are even being drawn into the Enron debacle. Brokerage firms that engage in investment banking are under attack. I don't know why Congress would be eager to put the federal government in the business of regulating insurance. There seems to be a small upside in the possibility of insurer expense savings as a result of uniformity but a politically damaging downside should things go wrong. The public distrust of bigness remains. Insurers are viewed as big business.

There have been instances when federal regulators just plain don't agree with the industry they regulate. We should not forget that insurance can be and has been a national

political target as was exhibited during the Clinton administration. A regulator can do an enormous amount of damage, particularly when all an insurer's eggs are in one basket as would be the case with federal regulation. Just as the Chevron case provided a basis for the OCC to expand banking powers through regulatory deference in court decisions, it would, conversely, create a barrier to judicial relief from adverse decisions of a federal insurance regulator. State courts do not generally give the same deference to administrative agencies. State courts tend to have a more open attitude in adjudicating differences between administrative agencies and the industries they regulate.

Many of you are bankers who advocate federal insurance regulation. Your relationship with the OCC has been excellent. As a result it is logical to assume that a federal regulatory system for insurance would also create the same excellent working relationship and advocacy. I beg to differ on this point. Insurance is not banking. Aside from specific market regulation such as Truth in Lending and the Community Investment Act the OCC has not been required to engage in extensive market oversight. The OCCs regulatory activities have been focused on "safety and soundness". It has engaged market issues only to the extent of evaluating the risk associated with "loss of reputation" and "litigation".

The public will not accept a regulatory system for insurance that does not respond to its needs and specific problems. The relationship between an insurer and a policyholder or claimant often cannot be described as warm and friendly at the time of loss. Determining an amount of loss or coverage is not the same as calculating interest. Nebraska is a relatively small state. We get approximately 10,000 telephone inquires annually on insurance matters. About 3,000 of our 1,600,000 citizens file a formal grievance against insurers or agents each year.

Congress cannot turn its back on insurance market regulation. Insurance is just too controversial. There is no equality, economic or otherwise, between an insurer and the insured. There is simply too much history and too many problems for Congress not to assure that people are fairly treated. It is entirely possible that banking regulation will become more like insurance regulation than the converse. Predatory lending is now a buzz phrase that has congressional attention. It is also possible that the OCCs advocacy for, rather than the regulation of, debt cancellation contracts could hit the congressional radar screen. When it comes to protecting the public a balanced approach is required. State insurance regulation has that balance. State insurance regulators are not loved by the industry they regulate nor by the public they serve.

Congress sees and accepts the need for uniformity but should not want the responsibility. It must be involved to achieve uniformity but needs state regulators to serve constituents. Consumer issues such as insurance availability, underwriting rejections, rate increases and claim problems are local in nature. Congress would be wise to entrust this to local oversight. Besides, many congressmen do not trust a federal agency to handle such issues, as federal agencies have not created the best track record in responding to people's needs. The states are experienced at serving the public the way it should be served.

Federal regulations are generally far more complex and exacting than any one anticipated. The federal Health and Human Services recent regulation on privacy and health administration runs over 1000 pages. Even calculating something as simple as interest is complex under federal regulations. Federal agencies have imposed standard forms and loss ratio standards for medical supplement policies.

Could these examples portend what a federal approach to insurance regulation would be? While federal regulation may create uniformity it may also create standardization which would limit the ability of life insurers to compete with other financial services companies. Worse yet is the possibility that standardization will result in less competition, as small and medium sized insurers must rely on product differentiation to maintain a presence in the market.

What rationale is there for the public to support and finance two regulatory systems to accommodate special interests? In all likelihood the two systems would compete with one another, as is the case with banking? The National Banking Act of 1863 along with the 1864 and 1865 amendments created a dual system more by accident than by design. There had been many failures of state banks. There were also national monetary issues that needed to be addressed. The need for change was clear. National banks were authorized and a regulatory system was established to regulate them. The legislation also taxed state bank notes out of existence with the expectation that state banks could not survive without them. State banks did survive as a result of an unforeseen source of funds from demand deposits thus resulting in the dual system. There is no similar compelling need to create a dual insurance regulatory system.

The OCC recently criticized a bank that reverted to a state charter because the regulatory costs were less. It does appear that the relationship between the OCC and state banking regulators cannot be characterized as warm and cozy. I don't view this as healthy. It is difficult to envision how a smorgasbord insurance regulatory system would benefit the public. Many states have enacted "wild card" statutes that give state banks parity with national banks.

Major life insurers criticized me for advocating a system of "domestic deference" for product approval. They feared a "race to the bottom". It seems to me that the dual regulatory system the same life insurers advocate would encourage just such a race. But the converse could become true as well. Promoters of the dual system rationalize a bold change because they can always go back. What if the federal system becomes draconian? How could state regulators justify to their constituents not following suit?

One of the arguments for federal regulation is that state regulation inhibits the development of international business in what is a global economy. The criticism from the international community is that state regulation is a barrier to access US markets. Their issue is that if they are not able to access our markets they are in turn reluctant to give US insurers access to their markets. I find this criticism more rhetoric than substance. Foreign interests own seven Nebraska domiciled insurers. In addition, we have two domestic operations that have significant foreign interests. Berkshire Hathaway

owns Cologne Re, one of the largest German based reinsurers, and AFLAC has its insurance products in 25% of Japanese households. US insurers rely heavily on European reinsurance. European interests have acquired a number of significant US insurers.

There are several current issues that should give the industry pause in its advocacy for federal charters. It is becoming clear that the industry should not assume that Congress would bend to its wishes. Congress is faced with such a multitude of issues it is difficult for insurance issues to become a priority. While state legislatures also face many issues insurance matters are a priority.

The first example is the inability of the property and casualty industry to obtain relief from the infinite risk of loss from terrorism. The American Insurance Association initially had a reasonable proposal in the form of "Freedom Re". It closely resembled Great Britain's successful "Pool Re". The House, while taking action destroyed the concept and the Senate has yet to act.

A second example that raises concern is the inability of the industry to affect meaningful tort reform at the federal level. Such reform is desperately needed if our nation is to remain the economic engine for the world. Change is also needed at the international level as well as documented in the OECD paper "Expanding Systemic Risks: the Consequences for Insurers, Enterprises and the Role of Governments". The uncertainties created by an unpredictable tort system will lead to capital restrictions and requirements for higher rates of return. The retro application of today's and future standards to past acts may well change forever how we structure corporations. If the industry can't obtain reform for an issue as clear as this it's difficult to comprehend how it can effect predicable outcomes from a federal regulatory system.

While it was time for Congress to act on financial modernization it's become clear that the convergence between banking and insurance underwriting has not taken place. In fact, Citicorp, which put a gun to the head of Congress, has subsequently moved in the opposite direction by shedding Travelers. As with Chicken Little, credibility could be called into question. Does the industry really need federal regulation to achieve reforms?

The state based regulatory system will take more direction from Congress on specific issues. The question of a national charter will remain as some Congressmen find its continued existence can supply a ready source for campaign contributions. I do not believe that the time is near when Congress will seriously entertain a federal charter. There will be preemption of state laws and regulatory processes that are not in the national public interest. What I envision is a working partnership between Congress and state governments to assure that the public is best served