Congressional Research Service

CRS Issue Statement on Insurance Regulatory Reform

Rawle O. King, Coordinator
Analyst in Financial Economics and Risk Assessment

March 10, 2009

Congressional Research Service
7-5700
www.crs.gov
IS40332

CRS Report for Congress
Prepared for Members and Committees of Congress

Given its constitutional role under the "general welfare" and "interstate commerce" clauses of the U.S. Constitution to promote national economic growth, Congress has legislative and oversight responsibilities over the financial health and stability of the business of insurance because the industry is a key player in the U.S. economy. Despite the widespread role insurance plays in the economy and its interconnectedness with other sectors of the financial services system, insurance remains largely regulated by individual states, and not the federal government. Although there is a substantial amount of standardization, insurers operating in multiple states are still subject to separate and mostly non-uniform requirements pertaining to licensing, investments, rates and forms, taxation, and other matters from one state to another. This non-uniform regulatory scheme has led to proposals for a federal regulatory system, particularly given the regulatory gaps that American International Group (AIG), a financial services holding company with major insurance components, exploited.

Insurance plays a vital role by providing protection against the financial consequences of fires, windstorms, auto accidents, on-the-job injuries, illnesses, and other perils. Society could not function without this protection because there would be so much uncertainty, so much exposure to sudden, unexpected and possibly catastrophic loss, that it would be difficult for anyone to plan with confidence for the future. The industry, however, is much more than just a protector. The insurance industry contributes hundreds of billions of dollars to the Nation's Gross National Product and credit markets, employs millions of Americans, and pays taxes, an important source of revenue for state governments and the federal government.

Today's global financial crisis has, in large part, been caused by a lack of adequate disclosure and by the inability of financial sector regulators to identify, in timely fashion, the specific market sectors, transactions, and transaction elements that are in need of greater transparency. Many of the world's largest financial institutions use non-transparency as a competitive advantage, or to maintain profit margins and stabilize fee income. Accordingly, they have generally resisted transparency (e.g., disclosing internal underwriting standards which, by their nature, often reveal their insights into risk-taking and past financial performance). A correction of this situation would arguably require reliable meaningful data, as well as analytics. By making markets more transparent, market participants and other interested parties, including the public, could develop greater confidence in the integrity of financial transactions, thereby generating large and reliable transaction volumes resulting in more consistent overall liquidity.

In this regard, the current 50-state insurance regulatory system in the United States continues to be criticized as an inefficient anachronism with insufficient regulatory resources in the current environment. Insurance regulators, regardless of the level of governance, do not have the tools or the information needed to perform their appropriate roles for 21st century financial markets and structured financial instruments such as collateralized mortgage obligations (CMOs), collateralized debt obligations (CDOs) and credit default swaps (CDSs). The 2009 financial market turmoil has made clear the need for a new financial market model – one that connects seamlessly to existing models, but improves on them in important ways. Continuing to operate financial markets in the same way as they have in the past, even with additional regulatory requirements, might not suffice.

Others argue the current system has been responsive to consumer problems and local conditions in a way that a federal agency could never be. Faced with rapidly changing economic conditions, the U.S. insurance regulators in 2008, for example, demonstrated flexibility and innovation in regulation, combining core principles of consumer protection and industry support to help the industry manage through the worst financial crisis since the Great Depression. Insurance

regulators worked with the Federal Reserve Board and the U.S. Treasury on the AIG rescue plan, proposed new regulations and implemented plans to stabilize the financial guaranty market, and facilitated the injection of tens of billions in new capital to support financial guaranty insurers which helped local municipalities maintain access to the municipal bond market.

Specific Policy Questions

1. Americans are suspicious of governmental regulatory activity as heavy-handed, inefficient, and disruptive of natural harmony, and yet when problems such as the current global financial crisis reach a certain level of intensity, they demand that governmental regulators immediately do something to solve them. What actions should the federal government take to address the lack of information within the federal government of the insurance industry? Could this information be efficiently obtained under the current 50-state regulatory system? Is there a need for free-flowing real-time federal information gathering?
2. Do state insurance regulators need more data and analytics to assess risk that would help them understand and manage the extent to which risk has been diversified beyond consumer and corporate credit and government debt?
3. Insurance regulation generally focuses on market conduct and insurer solvency. Both aspects were disabled by an absence of information. Is it appropriate to adopt a federal approach for tracking all underwriting and risk-related elements for insurance/reinsurance, loans and lines of credit, and related financial products?
4. Should Congress play a more active role in creating policy that specifically restores confidence in the financial marketplace? If so, does this mean complete federalization of the insurance regulatory system or creation of a dual system similar to state and national banks?
5. Should Congress provide an explicit financial guaranty to specific types of structured finance/insurance products?

Issue Team Members

Rawle O. King, Coordinator
Analyst in Financial Economics and Risk Assessment
rking@crs.loc.gov, 7-5975

D. Andrew Austin
Analyst in Economic Policy
aaustin@crs.loc.gov, 7-6552

David H. Carpenter
Legislative Attorney
dcarpenter@crs.loc.gov, 7-9118

Janice E. Rubin
Legislative Attorney
jrubin@crs.loc.gov, 7-9079

Bernadette Fernandez
Analyst in Health Care Financing
bfernandez@crs.loc.gov, 7-0322

Michael V. Seitzinger
Legislative Attorney
mseitzinger@crs.loc.gov, 7-7895

Baird Webel
Specialist in Financial Economics
bwebel@crs.loc.gov, 7-0652

Carolyn V. Torsell
Information Research Specialist
ctorsell@crs.loc.gov, 7-7888