

## Preserving State Insurance Regulation...

- By interacting with Congress on issues of critical importance to insurance public policy
- By educating state lawmakers on the solutions to their insurance-market crises
- By fostering relationships between state legislators
- By asserting the primacy of state insurance regulation under the McCarran-Ferguson Act of 1945

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## SUBPRIME CRISIS STIRS BOND MARKET TROUBLE

Subprime lending has taken another victim, stirring trouble in the historically well-rated bond insurance market and prompting—in addition to quick action by the New York Insurance Department—a key House subcommittee to investigate the impact of rating downgrades on local government financing.

The flurry began on Friday, January 21, when Fitch downgraded Ambac Financial's strength rating from AAA to AA and downgraded more than 400 of the asset-backed security classes held by an Ambac subsidiary. Fitch, Moody's, and Standard & Poor's also began reviewing and/or downgrading other bond insurers, including MBIA which, along with Ambac, accounts for almost 50 percent of the U.S. market. AAA ratings are critical for these bond (otherwise known as financial guaranty) insurers—who typically back low-risk government and corporate bonds that help finance infrastructure and other efforts.

The problem arose when bond insurers acknowledged their sizeable fourth quarter losses as a result of investments tied to subprime mortgages. The heavy

subprime exposure reportedly took Wall Street by surprise. In response to concerns regarding market stability, the NY Insurance Dept. encouraged Warren Buffett's Berkshire Hathaway to open a new bond insurer that might infuse more capital into the industry. Berkshire accepted the offer.

On Capitol Hill, Rep. Paul Kanjorski (D-PA), chair of the House Capital Markets, Insurance & Gov.'t Sponsored Enterprises Subcommittee, held a February 14 hearing to examine the bond insurance market, focusing on "its strength, the resulting implications for the financial marketplace and municipalities of ratings downgrades, and the potential need for regulatory reform."

For their part, Ambac and MBIA say capital concerns are exaggerated, that the fourth-quarter hits—\$2.3 billion for MBIA alone—would not endanger solvency and, regardless, would be paid over time, rather than all at once.

The financial guaranty insurance industry began in the 1970s. In addition to MBIA and Ambac, other insurers include, among others, ACA Capital, Assured Guaranty, Radian Asset Insurance, and XL Capital.

## SOUTH CAROLINA GOVERNOR IGNITES WORKERS' COMP FIGHT, HEADS TO FEDERAL COURT

South Carolina Governor Mark Sanford has inflamed parties to the state workers' compensation system, bitterly dividing the state's legal, regulatory, and political communities over his controversial—and some say unconstitutional—executive orders. The governor will appear before state Supreme Court in the coming weeks to defend his directives.

The orders, which took effect in January 2007, require state workers' comp commissioners to confirm that attorney fees are reasonable and to employ American Medical Association physician guidelines for rating permanent impairment. To confirm use of the guides, commissioners

must now submit detailed filings of the awards they give.

Workers' comp commissioners say the orders conflict with their ability to be independent and impartial. Legal experts and lawmakers argue that the orders clearly violate state laws requiring the legislature to approve new workers' comp regulations. In fact, the legislature had debated the merits of such guidelines last summer as part of a comprehensive reform bill and ultimately opted against their use.

Sanford—who will appear in court as part of a lawsuit against the commission over its compliance with the directives—argues that the medical

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**VIEW FROM THE HILL: TIME FLIES, WHEN HAVING FUN?**

2008 rhetoric is being thrown high and fast lately as Congress makes bold statements on insurance regulatory reform and readies to complete a much-publicized economic stimulus package—only weeks after reconvening.

Senate Banking Committee Chair Sen. Chris Dodd (D-CT) returned from the campaign trail with a roar in January when he announced that his Committee’s 2008 priorities would include “examining” surplus lines and reinsurance reform, discussing optional federal charter (OFC) proposals, and reforming and reauthorizing the National Flood Insurance Program (NFIP)—noting specifically that a hold was placed on NFIP reform legislation.

While press statements from OFC proponents have continued to sing praises to efforts for a new federal insurance bureaucracy, supporters were dealt a blow when OFC sponsor Sen. John Sununu (R-NH) gave up his seat on the Banking Committee to join Finance—reportedly to improve his fund-raising options in advance of a tight re-election campaign. Dreams of a wide-ranging federal role were fur-

ther dashed when House Financial Services Committee Chair Rep. Barney Frank (D-MA) alluded to “bifurcating” OFC legislation—acknowledging difficulties associated with a property-casualty bill.

Meanwhile, President Bush and House leaders compromised on an economic stimulus package designed to respond to the slumping economy. In a 385 to 35 vote on January 29, the House passed a plan that would provide rebates of \$600 to \$1,200 to most taxpayers. The proposal would send some relief to people with at least \$3,000 in income, and provide an additional \$300 per child boost to families—while denying such rebates to the richest taxpayers.

The proposal now heads to the Senate where members are unlikely to rubber stamp the House- and President-backed package. Finance Committee Chair Max Baucus (D-MT) has developed his own proposal that would reduce rebates to between \$500 and \$1,000 per individual or couple, and add billions of dollars for senior citizens and the unemployed. While it’s too early to tell what package will reach the President’s desk, one thing is certain: the clock is ticking.

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**FACT FINDINGS: STATE HEALTHCARE COSTS “UNSUSTAINABLE,” GAO SAYS**

*A January 22 General Accountability Office (GAO) report foreshadows fiscal trouble for state and local governments if they—and the feds—do not rein in runaway healthcare costs. Below are excerpts from the study, entitled State and Local Governments: Growing Fiscal Challenges Will Emerge during the Next 10 Years.*

“Continuing on this unsustainable path will gradually erode, and ultimately damage, our economy, our standard of living, and potentially our domestic tranquility and national security. This is a challenge that needs to be addressed with a greater sense of urgency...since time is currently working against us.”—page 2

“[Under one scenario], by 2050, state and local taxes as a percentage of GDP would have to rise by about 17 percent...to avoid fiscal deficits. In other words, it would take a substantial increase in taxes—a considerably faster increase than that experienced historically—to maintain a nonnegative operating balance solely through increased taxes.”—page 16

“...the expected continued rise in health care costs poses a fiscal challenge not just to government budgets, but to American business and society as a whole. The fundamental fiscal problems of the federal government and these subnational governments are similar and are linked.”—page 19

## POINT-COUNTERPOINT: CONSUMERS AND AN OFC

Congress is once again considering proposals to create an optional federal charter (OFC) for life and property-casualty insurance—scheduling hearings on the need for reform and examining S.40/H.R. 3200, the *National Insurance Act of 2007*. NCOIL firmly opposes an OFC, as it would erode consumer protections, bifurcate oversight, draw key state premium tax income, and endanger guaranty funds, among other items.

Those against and for an OFC cite the impact it would have on consumers. The commentators below lay out their arguments.

### Optional Federal Charter: Unnecessary, Confusing, and Expensive

By Alabama State Rep. Greg Wren

On May 24, 2007, Senator John Sununu (R-NH) and Senator Tim Johnson (D-SD) introduced S.40, *The National Insurance Act of 2007*. The House version of the bill, H.R. 3200, was introduced in July 2007 by Congresswoman Melissa Bean (D-IL) and Congressman Ed Royce (R-CA).

An optional federal charter (OFC) would allow insurance companies to choose between state or federal government regulation. However, creating an industry-friendly “optional” regulator is at odds with one of the primary goals of insurance regulation—providing consumer protections. Consumers will be forced to contact Washington, D.C.,

for resolving disputes with federally chartered insurance companies. OFC legislation also weakens the authority of state attorneys general and other state officials to protect consumers in their state. An OFC would not be optional for consumers—only insurance companies—thereby confusing consumers and creating havoc under a dual state and federal insurance regulatory system.

The creation of a federal insurance regulator will risk state revenues necessary to fund a vast array of state government operations such as Medicaid and CHIP programs, public and mental health services, law enforcement, senior citizen services, and economic development programs. In 2006, state governments received over \$13.4 billion in state insurance premium taxes and \$2.75 billion from non-premium tax revenues (e.g. fees and assessments).

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### “Why can’t I buy insurance like I use my ATM?”

By Kevin McKechnie

Good question. Americans may access their money through ATM networks no matter where they are. ATM transactions are seamless: they don’t depend upon whether the bank is state or federally regulated.

Nor does it matter that a consumer’s account is in one state and they now live in another. The Internet revolutionized the way consumers access money, apply for mortgages, and manage investments. Formerly in-person transactions now benefit from significant automation.

Why isn’t helping consumers meet their insurance needs just as easy?

One answer is that the state insur-

ance regulatory system is so focused on preserving its traditional role that scandalously little progress has been made actually modernizing insurance regulation. For example, the Gramm-Leach-Bliley Act mandated either a uniform or reciprocal licensing system for insurance agents. Eight years later, forty or so states have agreed to a reciprocal, not uniform, licensing system. Instead of eradicating disparate licensing standards, the system preserved them and we are no closer to uniform standards than we were before.

Why should this matter to consumers?

Simple, Americans move around. A customer that purchased an annuity from his bank in Boston but then retired to Florida would have to find a new insurance advisor if the one in Boston did not hold a Florida insurance license. This is unnecessary. The

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# NCOIL

## OPTIONAL

An OFC would create a complex maze of unnecessary and overlapping licensing requirements for insurance agents and brokers. In addition, an OFC also has the potential to create a competitive disadvantage for many small and medium-size insurance companies which may not be able to afford switching back and forth between state and federal regulation—thus they could potentially be stuck in a less favorable regulatory environment.

While there is no crisis in the insurance industry that would warrant the creation of a federal insurance regulator, the current state-based insurance regulatory system needs to be reformed and modernized. Such reforms can be achieved through targeted federal legis-

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lation. Targeted legislation, an example of which is the *Nonadmitted and Reinsurance Reform Act of 2007*, can bring about uniformity and improve efficiencies in the state-based insurance regulatory system without taking the drastic step of creating a massive new federal bureaucracy.

In conclusion, optional federal charter legislation would create a massive new federal bureaucracy far-removed from the states. It would threaten consumer protections, risk a loss of critical state revenues, dismantle the nation's 135 years of state-based insurance protections, and lead to a burdensome and unnecessary system of insurance laws and regulations.

*Mr. Wren is Executive Director of the Coalition Opposed to a Federal Insurance Regula-*

## “WHY...”

annuity didn't change; only the customer's address changed.

Compare that with managing investments. Registered representatives are licensed by FINRA; the customer can continue his relationship with his bank in Boston from his patio in Florida.

This disparity must be corrected—quickly.

Instead of waiting for the state system to try—and fail—to provide uniformity, creating an Optional Federal Charter helps consumers immediately. Bi-partisan OFC legislation pending in Congress would provide a solution to the disparate consumer protection laws managed by the states. With the pending retirement of 77 million baby boomers, this is not going to be a small issue. Having a single—and rigorous—national sales and marketing regulatory

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regime will greatly reduce the opportunity to defraud seniors.

Additionally, the cost of manufacturing insurance products in just the life insurance industry would be reduced by \$5.7 billion dollars annually. This is the difference between having to comply with one set of national rules and rules from fifty-six separate regulators.

Currently, the state system is designed to be expensive, impervious to reform, resistant to efficiency and utterly hostile to the idea of better products, more speedily available and at lower prices. For consumers, this is a raw deal.

*Mr. McKechnie is Executive Director of the American Bankers Insurance Association (ABIA), based in Washington, DC, and a leader of the Optional Federal Charter Coalition.*

## SOUTH CAROLINA

impairment guidelines impose an equitable, efficient structure on what he views as an arbitrary benefit system. With SC facing its third rate increase in as many years, Sanford suggests, the directives will control costs, provide a fair process to injured workers, and create a more attractive business climate.

Insurer reps support Sanford's effort to improve what they also see as

*(continued from page 1)*

an unfair award mechanism. Critics, including counsel for injured workers, say he is trying to shift money away from victims toward business and insurer interests.

### CORRECTION

The January *NCOILetter* inadvertently listed Rep. Carl Von Epps (GA) as co-chair of the Health, LTC & Health Retirement Issues Committee. Rep. Epps is vice chair.