

# The New York Times

## New York Times: Insurer Oversight Is Not Yet Broken

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"Inefficient" financial regulation turns out to have its charms. At least that's the argument of state insurance regulators, many of whom oppose the federal government's attempt to gain oversight of the industry. The feds say the state system is outdated, hampers innovation and keeps insurance a financial backwater. That's not an entirely bad thing.

State-based insurance oversight, dating from the nineteenth century, is currently facing several challenges. Lawmakers have introduced a bill that would give insurers the right to choose a national charter, thereby falling under the federal government's oversight. The Treasury's blueprint for financial reform also calls for a dual-charter system.

At first glance, the drive to change insurance oversight seems odd. After all, plain vanilla insurers haven't been at the center of the financial storm. Even American International Group's state-regulated insurance operations are largely unscathed -- it was the financial products group overseen by federal watchdogs that caused the carnage, requiring a huge \$180 billion government bailout. That part of A.I.G. only began to run amok after the company set up a thrift, allowing it to operate its noninsurance operations under the oversight of the Office of Thrift Supervision, the federal agency that also allowed problems to multiply at Countrywide, Washington Mutual and IndyMac.

True, insurance companies have invested in structured investments and offered products like variable annuities that may eventually cause them a lot of pain. But most have avoided excessive debt and remain well capitalized and able to meet obligations to customers without government support, unlike many of their banking counterparts. This is largely because state regulators have traditionally been extremely conservative.

They coordinate their efforts through the National Association of Insurance Commissioners, a forum for forging a consensus on regulatory changes. If a proposed rule secures two-thirds support, the regulators submit it to their 50 respective state legislatures to be enshrined in law. But garnering support from so many regulators is tough, so the pace of change is slow.

State regulators are also closer to their constituencies than federal overseers, and so tend to be relatively more concerned with consumer protection, which makes them leery of change. Insurance regulators also typically assume that consumers shop for policies primarily based on price, so they work to keep the complexity of the products on the market to a minimum.

The duplicative nature of the system also increases the odds that problems will be uncovered. That's because insurers operating in more than one state are scrutinized by more than one regulator. Indeed, this sort of belt-and-suspenders approach has helped unmask several instances of fraud.

One high-profile example was when Mississippi insurance regulators picked up on problems with Martin Frankel's operations in 1999; watchdogs in four other states where he operated did not. In part because of Mississippi's investigation, he was charged with, and later pleaded guilty to, insurance fraud.

By comparison with this healthy competition and duplication of efforts among states, a dual state/federal charter system would risk prompting insurers to go venue shopping, looking for the most accommodating regime, as banks have done in the past. Insurers eager to reduce compliance costs and expand more rapidly would be happy to escape state regulators' conservative embrace. And if they signed up with a federal watchdog, they could focus all their lobbying firepower on one target, rather than having to potentially spread it among those in several states.

Competition among state and federal bank regulators has occasionally bordered on destructive power-grabbing. For example, federal watchdogs have brought lawsuits to keep states from enforcing consumer protection laws -- like those on predatory lending -- against nationally chartered banks. The Supreme Court heard New York's appeal of such a lawsuit on Tuesday.

Of course, decentralized insurance regulation may make it more difficult to identify broader systemic risks. But that's not sufficient reason to hand sweeping authority to discredited federal regulators. State insurance oversight may not be ideal, but for now it appears preferable to the alternative.

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