

This job is for states to do

By **MARK PETERS**

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In the congressional debate over regulatory reform, one area that so far has managed to fly under the radar is the question of who should regulate the nation's insurance industry - the federal government or the states -- and whether the insurance companies should be allowed to choose their own regulator. These issues could have far-reaching consequences for every individual and business in America.

Insurance is what offers us reassurance that if our house blows away in a tornado or is destroyed by fire, we won't lose everything. It gives us the confidence to drive a car or run a business. In short, it makes our way of life possible.

New York has more insurance company headquarters than any other state. The industry here employs nearly 150,000 and collects more than \$140 billion a year in premiums, more than 9 percent of the U.S. total. Obviously, effective regulation of insurers is essential to protecting the industry, consumers and our economy.

Since the birth of the U.S. industry, insurance companies have been regulated by the states. Most observers give the states fairly high marks for ensuring the safety of traditional insurance products and the solvency of the companies through strict reserve requirements that ensure they have enough cash on hand to pay claims.

But in the aftermath of American International Group's near-collapse, some within the insurance industry are lobbying Congress for a change in the system that would grant companies the freedom to pick their regulator -- state or federal -- much as banks were able to do in the run-up to our current financial crisis.

The problem with this approach, known as "optional federal charter," is that it would give insurers the ability to choose the friendliest regulator, with the loosest rules, in a race to the bottom, a tactic reminiscent of "If Dad says no, ask Mom."

The regulatory response to AIG's near-collapse must not become a Trojan horse to usher in this kind of "regulator shopping" disguised as stronger regulation.

The facts about AIG actually vindicate state regulation of insurance. AIG's financial products division, not its insurance companies, caused the parent company's massive losses.

In fact, the federal bailout was made possible by the prospect that AIG will eventually be able to repay the government through the sale of its solvent, profitable assets -- its insurance companies. They remain solvent, in no small part, thanks to effective regulation by the states.

The Obama administration has made a compelling case for a federal role in regulating insurance in certain areas -- for example, increased oversight of all financial companies whose failure would pose a systemic risk; and the huge market in credit default swaps, an insurance-like product offered by banks and some insurers, and regulated, so far, by no one.

Most insurers, however, are not big enough to pose a systemic risk and have not made huge bets on swaps. Many are local or regional companies with regulatory issues involving items such as flood insurance on Long Island or hurricane coverage in the Gulf states. Nearly half of the nation's property/casualty firms are local or regional. It makes more sense to regulate these companies in their own backyards.

There's another reason to avoid weakening the states' role in regulating insurance: doing so could undermine the national network of insurance guaranty funds, based in the 50 states, that provide an effective safety net protecting consumers from insurer default.

While everyone is aware of the FDIC's role in protecting depositors from bank failures, most people are unaware of the guaranty fund system. Although coverage limits vary by state and type of insurance, these funds pay claims and provide continuing coverage to policyholders in the wake of an insurer's insolvency.

So by all means, let's address systemic risk and credit default swaps.

But as Congress and the administration work toward a new system to prevent future meltdowns in the financial markets, they should "first do no harm" to our state-based system of regulating insurers and protecting their customers.

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