Michael T. McRaith
Director
Federal Insurance Office
Department of Treasury
1500 Pennsylvania Avenue, NW.
Washington, DC 20220.
VIA REGULATIONS.GOV

Re: Comments on Report to Congress on How to Modernize and Improve the System of Insurance Regulation in the United States

Docket number: 2011–26776

November 29, 2011

Dear Mr. McRaith:

The Heartland Institute is a research and educational organization devoted to discovering, developing, and promoting free-market solutions to social and economic problems. Through offices in Chicago, Washington, Texas, and Ohio, Heartland consistently has advocated an insurance environment that allows consumers to purchase the insurance products they want and allows insurers to sell them.

As such, Heartland welcomes the opportunity to offer input on ways to modernize and improve the U.S. system of insurance regulation. Our comments will focus on systemic risk regulation with respect to property and casualty insurance and reinsurance and the market inefficiencies fomented by state rate controls and large state-controlled residual market entities. We also offer comments on what we see as the proper role of the Federal Insurance Office in gathering, analyzing, and disseminating insurance data. In this context, we offer comments on topics one, three, four, six and seven. Throughout, our analysis will focus on property and casualty insurance and reinsurance, as we have not conducted extensive analysis of the life, health, title, mortgage, and financial guaranty insurance industries. Our comments follow:

1. Systemic risk regulation with respect to insurance

We believe the business of property and casualty insurance does not currently pose a systemic risk to the national or global financial markets and that it is unlikely that it will at any point in the near future.

Property and casualty insurance is a large industry and an important part of the nation's financial services sector. During 2010, property and casualty insurers earned $420.5 billion in premiums and incurred slightly more than $300 billion in losses.[1] Despite the

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[1] Robert R. Hartwig. "2010 Year End Results," Insurance Information Institute, April 20, 2011, http://www.iii.org/articles/2010-year-end-results.html

industry's importance, it remains highly stable for three reasons: It is highly competitive, failures are relatively rare, and prudential regulation prohibits companies from becoming highly leveraged.

The highly competitive and dispersed nature of the property and casualty insurance market alone guards against any single insurer becoming systemically significant. Figure 1 lists the market shares of the top property and casualty insurers.

Figure 1: Top P&C Insurer market shares.

Rank	Group	Direct premiums written (1)	Market share (2)
1	State Farm Mutual Automobile Insurance	$52,378,166	10.9%
2	Zurich Financial Services Ltd. (Farmers)	27,442,024	5.7
3	Allstate Corp.	25,863,277	5.4
4	American International Group (Century 21 and others)	25,569,346	5.3
5	Liberty Mutual Holding Co.	25,318,187	5.3
6	Travelers Cos.	21,541,289	4.5
7	Berkshire Hathaway Inc. (GEICO and others)	16,560,344	3.4
8	Nationwide Mutual Group	14,875,572	3.1
9	Progressive Corp.	14,699,901	3.1
10	USAA Insurance Group	11,235,772	2.3

Source: Insurance Information Institute, http://www.iii.org/facts_statistics/insurance-company-rankings.html

Based on these statistics and other data provided by SNL Financial, the industry-wide HHI (Herfindahl-Hirschman Index, the measure of market concentration used by the U.S. Justice Department and most academics) is about 975. In the guidelines developed by the DOJ and Federal Trade Commission for horizontal mergers, the government regards a market with an HHI below 1,000 as "un-concentrated"; one with an HHI between 1,000 and 1,799 as "moderately concentrated"; and one with an HHI above 2,500 as "highly concentrated."[2] Indeed, even if there were no firms besides these ten writing property and casualty insurance—and there are actually hundreds—the HHI still would be roughly 1,100, indicating a competitive market. Quite simply, the competitiveness of the property and casualty insurance market strongly argues against the systemic importance of any

[2] United States Department of Justice. "THE HERFINDAHL-HIRSCHMAN INDEX," http://www.justice.gov/atr/public/testimony/hhi.htm

given P&C insurer. The failure or withdrawal from the market of any firm would be quickly displaced by other competitors.

From time to time, insurers do fail, but such failures are relatively rare. Figure 2 lists the largest insolvencies of the past quarter century.

Figure 2: Major Insurer Insolvencies 1987 to present

Year	Insolvent company	Payments	Recoveries	Net cost
2001	Reliance Insurance Company	$2,867,396,756	$1,751,608,142	$1,115,788,616
2002	Legion Insurance Company	1,481,687,959	453,266,892	1,028,421,067
2000	California Compensation Insurance Company	1,105,143,857	354,332,213	750,811,644
2000	Fremont Indemnity Insurance Company	1,045,377,198	723,963,519	321,413,679
2001	PHICO Insurance Company	776,821,738	247,393,029	529,428,708
2006	Southern Family Insurance Company	719,122,670	324,363,428	394,759,242
1988	American Mutual Liability Insurance Company	586,648,605	255,701,413	330,947,192
1985	Transit Casualty Insurance Company	567,967,111	388,722,447	179,244,664
1986	Midland Insurance Company	552,585,201	87,693,851	464,891,350
1987	Mission Insurance Company	507,133,775	589,318,750	-82,184,975

Total: $5,033,521,187
Source: National Conference of Insurance Guaranty Funds, via the Insurance Information Institute

Importantly, none of the ten largest insurance insolvencies occurred during the financial crisis of 2008 and 2009. The total cost of the ten largest insolvencies is less than half the direct premiums written of the tenth largest property and casualty insurer in a single year. Quite simply, there is no historical record of insurer insolvencies that would endanger the systemic stability of the economy overall.

State-level capital and solvency regulation of property and casualty insurers also prohibits them from relying heavily on borrowed capital. According to regulations in all states, in accordance with national accreditation standards promulgated by the NAIC, an insurer must have a combination of private sector recognized risk transfer and other hard, stable assets (cash, high quality bonds and the like) to assure their ability to pay claims. This further reduces the chances that a company engaged in the business of insurance could pose a systemic risk.

Insurers and insurance groups are sometimes held by financial services conglomerates that may pose systemic risk and some large insurance groups engage in activities that could potentially warrant their regulation as systemically important for other reasons. This was clearly the case at American International Group. AIG's Financial Products unit was a major counterparty on credit default swap guarantees of collateralized debt obligations and proved unable to make large collateral calls without federal assistance. The company also faced difficulties meeting collateral calls on its securities lending business and in rolling over the debt of its consumer credit and aircraft leasing businesses.

However, AIG's core life and P&C insurance subsidiaries held up well throughout the crisis and AIG policyholders were protected by strong solvency regulation. Thus, we do not believe that possession of a large P&C market share *per se* should ever lead to a company being considered systemically important.

3. **Consumer protection for insurance products and practices, including gaps in State regulation and access by traditionally underserved communities and consumers, minorities, and low-and moderate-income persons to affordable insurance products**

We believe the most important consumer protection is to monitor the safety and solvency of insurance companies. This should be the primary focus of any system of insurance regulation. This said, we believe there are steps the Federal Insurance Office can take to greatly improve the transparency of insurance markets for consumers, including crucial actions that we believe would not require any additional enabling legislation. In particular, FIO should use powers created under the Dodd Frank Act to release information that is currently not easily available to consumers.

Under the Dodd-Frank Act, the FIO is empowered to "receive and collect data and information on and from the insurance industry and insurers; enter into information-sharing agreements; analyze and disseminate data and information; and issue reports

regarding all lines of insurance except health insurance."[3] The law grants the Office limited subpoena powers but specifies that it must turn first to state or federal regulatory agencies, or to publicly available sources, before making any direct requests of insurers or their affiliates. The statute also specifies that confidentiality agreements between, for instance, regulated insurers and their state regulators continue to apply even after that data has been transmitted to the federal office. The Dodd-Frank Act is clear that Title 5 Section 552 of the U.S. Code, better known as the Freedom of Information Act, "shall apply to any data or information submitted to the Office by an insurer or an affiliate of an insurer."[4] It is more vague in the degree to which FOIA applies to insurance data provided to the office by a state or by another regulatory authority. One section of the law specifies that entities that share information with the federal office that isn't publicly available retain "any privilege arising under Federal or State law…to which the data or information is otherwise subject."[5]

Our reading of that section of the law suggests that a state that has exercised a privilege not to make certain information publicly available does not waive that privilege simply because it has shared those reports with the federal office. But we are not aware of any privilege under state or federal law that would prohibit the FIO itself from making data shared with it by a state or other regulatory agency publicly available. Indeed, both the office's statutory charge to "disseminate data and information" and the requirements of the Freedom of Information Act would appear to compel that FIO share widely that insurance data it collects from the states.

We find this piece of the statute relevant because of the practice by state insurance commissioners – unique, to our knowledge, among financial services industry regulators – to hold insurance data as proprietary and to share it primarily with a single private entity: the National Association of Insurance Commissioners. While the Securities and Exchange Commission makes filings by publicly traded companies publicly available at no charge through its EDGAR service and the Federal Reserve Board makes quarterly and annual reports by bank holding companies publicly available at no charge through the National Information Center, the NAIC jealously guards the quarterly and annual statutory financial statements of insurance companies, using sales of that data to fund its operations.

According to the NAIC's recently released 2012 budget proposal there are now 400 million data elements in the NAIC's Financial Data Repository, which is used as the primary source for some 193 NAIC publications and data products.[6] The group projects it will earn $25.9 million in 2012 from database filing fees paid by the industry and

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[3] PL 111-203. "The Dodd Frank Wall Street Reform and Consumer Protection Act," http://www.gpo.gov/fdsys/pkg/PLAW-111publ203/pdf/PLAW-111publ203.pdf

[4] Ibid

[5] Ibid

[6] National Association of Insurance Commissioners. "Proposed Budget, 2012," http://www.naic.org/documents/about_budget_2012_proposed_budget.pdf

another $18.9 million from sales of its insurance data products. Together, those items represent 57.3 percent of the group's $78.2 million in projected 2012 revenues.

The major clients for the NAIC's statutory insurance data are market analytics firms who repackage and resell the information to major institutional clients for significant sums of money. Policyholders, consumer advocates, academics, researchers, journalists, and others who might be interested in raw statutory data in electronic format are largely priced out of being able to afford what, by any measure, should rightfully be publicly available information.

We believe there is an opportunity for the FIO to clarify this area of the Dodd-Frank law by making clear that non-confidential statutory data is a public resource that should be shared through a web portal similar to the SEC's EDGAR service. Public transmission of publicly collected data about the financial health of the companies they entrust to protect their assets and their lives is the least that consumers should expect from the new Federal Insurance Office. Broad dissemination of non-confidential insurance financial data also would permit many eyes – including new, existing, or open source credit rating agencies – to parse trends in the industry and call attention to potential risks that may have escaped the eyes of regulators.

Some have suggested that, without the revenues from its sales of insurance data, the NAIC would be unable to provide a variety of services that it currently offers to the states. We understand why that would be a concern but suggest that, to the degree that state insurance departments lack appropriate funding, it is because state legislatures have raided regulators' dedicated revenue streams for other purposes. Based on the NAIC's 2011 Insurance Department Resources Report, the 50 states, Puerto Rico, and the District of Columbia spent $1.24 billion on insurance regulation in 2010 but collected double that amount, $2.48 billion, in regulatory fees and assessments from the insurance industry. State insurance departments also collected $63.5 million in fines and penalties and another $1.22 billion in miscellaneous revenues. States separately collected $14.82 billion in insurance premium taxes. Altogether, of the $18.58 billion states collected from the insurance industry last year, only 6.7 percent was spent on insurance regulation. Surely, there are ways to pool those resources and procure shared services that would not require robbing the public of access to insurers' financial statements and statutory data.

But perhaps most importantly, public dissemination of insurance data by the FIO would hopefully bring to an end the absurd situation in which a private, nongovernmental entity is granted a monopoly over data collected with governmental resources. Across all industries, firms will often report that regulators tend to be indifferent or unsympathetic to complaints that requests for data consume time, resources, and manpower. That is perhaps an inevitable result of the relationship between regulated industry and its regulator. But in insurance, the relationship is further poisoned by an apparent conflict of interest. Regulators' pecuniary interest in obtaining insurance data for the purpose of reselling it on the market may actually be driving public policy decisions. There is no justification for allowing such a dynamic to persist.

4. **The degree of national uniformity of State insurance regulation, including the identification of, and methods for assessing, excessive, duplicative, or outdated insurance regulation or regulatory licensing process**

The state-based system of insurance imposes duplicative and sometimes contradictory mandates imposed on companies and other market players. We address some of the ways that the FIO and federal lawmakers should (and should not) investigate these matters in our answer to number seven below. In the context of this question above we urge that the Federal Insurance Office (and perhaps Congress as well) pay attention to the risks posed by the creation and growth of certain state-run entities such a residual markets and reinsurance mechanisms. These entities have their origins in state rate controls, which leave insurers in some markets unable to charge market-clearing prices and consumers in those markets unable to find coverage. Combined with rate controls, residual markets and the state-run reinsurance mechanism that exists in one state exemplify the type of "excessive, duplicative and outdated" insurance regulatory process that ought to be a topic of concern to FIO.

Rate regulation of insurance exists in some form for some lines of insurance in all fifty states as well as all U.S. possessions. A degree of rate regulation to assure solvency is, of course, a necessary and core function of insurance oversight. When rate regulation makes it impossible for consumers to find insurance at any price, however, political leaders will frequently react by expanding the size of residual market mechanisms.

In isolation, most of these residual property insurance market mechanisms--35 states maintain a total of 37 of them—have little or no significance for the insurance market at all. In some states, however, they have grown enormously. Florida's Citizens Property Insurance Corp., for example, writes almost 200,000 more policies than the state's largest private carrier and ranks as the largest homeowners' insurer in the state. The Texas Windstorm Insurance Association, likewise, writes nearly a third of all coastal coverage in that state and is the only entity willing to write coverage at all in some areas.

This situation is problematic and burdensome for the insurance market as a whole because, following major events, these entities fund themselves through assessments (typically passed onto consumers) on all property insurers operating in the state. And these assessments can destabilize markets and further reduce coverage. For example, in 2008 and 2009, several small insurers and one of the country's ten largest carriers withdrew from the North Carolina property insurance market entirely rather than run the risk of sizeable assessments that the state's Beach Plan could then impose on the market.[7] (North Carolina reformed its market to largely eliminate these risks.) But not all states have made these types of reforms: major national carriers have largely stopped writing

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[7] Eli Lehrer. " North Carolina's Beach Plan: Who Pays for Coastal Property Insurance," John Locke Foundation, December 2008, http://www.johnlocke.org/acrobat/policyReports/beach_plan_reform.pdf , 3

new policies in coastal areas of Florida as a direct result of Citizens' market interventions, and new carriers have been similarly reluctant to enter the Texas market.

The risk and burden posed by these residual market mechanisms is made more intense by the manner in which they themselves are regulated. Although the precise structure differs from state to state, many of the larger residual market mechanisms are overseen and controlled by the same authorities that oversee insurance regulation overall. When such overseers are elected officials or directly accountable to them, the frequent result has been political pressure to suppress rates. Appropriate risk-based rates would reduce the size of assessments significantly because they would presumably shrink these market mechanisms and leave them better able to meet claims obligations. Residual market mechanisms that compete directly with private carriers—as Florida's Citizens Property Insurance Corp. and the Texas Windstorm Insurance Association do—can serve as *de facto* price control mechanisms for markets as a whole. This creates a significant moral hazard for politically accountable regulators and those who appoint them.

The most important of these interventions is state involvement in reinsurance markets. In particular, the Florida Hurricane Catastrophe Fund, the only state-run general purpose property and casualty reinsurer in the country, poses enormous risks to that state's (and, perhaps, the nation's) insurance market that could also, as a direct result of Florida's regulations, require enormous assessments.[8] The Florida Hurricane Catastrophe Fund's own chief operating officer, Jack Nicholson, estimates that the Fund's potential gap between its hard assets and liabilities could be as large as $16.28 billion.[9] (Figure 3 includes the specifics) This includes a $6.0 billion optional Temporary Increase in Coverage Layer, which is set to be reduced by $2.0 billion in 2012 and for which the FHCF currently sells only about $1.0 billion in coverage.

Figure 3: FHCF Potential Capacity

$ 0.994 billion Temporary Increase in Coverage Layer
$ 17.000 billion Mandatory Layers.
$ 0.395 billion Optional Layers

Total: $18.389 billion
($7.17 billion) (Estimated cash on hand at end of CY 2011)

Total Bond Issue Needed: $11.219 billion
Source: Florida Hurricane Catastrophe Fund, 10-18-11 Bonding Capacity Estimates

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[8] In addition to the Florida Cat Fund, the reinsurance facilities for auto insurance in North Carolina and Rhode Island, as well as the Michigan Catastrophic Claims Association, serve highly specialized reinsurance-like functions for insurers. Although they may be worth monitoring, it seems highly unlikely that they pose an immediate systemic risk.

[9] Jack Nicholson. " Florida Hurricane Catastrophe Fund Advisory Meeting: May 17, 2011," http://www.sbafla.com/fhcf/LinkClick.aspx?fileticket=BPNxRCiHIKs%3D&tabid=991&mid=2808, Slide 14.

The Florida Hurricane Catastrophe Fund thus imposes a potential assessment liability of more than double the total assessments imposed as a result of all major insolvencies in the past quarter century ($5.033 billion, per Figure 2 above) since 1987. The bond issue would be larger than the $11 billion 2001 California issue that ranks as the largest municipal debt offering in history.[10] These assessments needed simply to pay interest on the bonds would be imposed directly on Florida's consumers, which could lead to any number of negative consequences, including widespread decisions simply to drop insurance rather than pay enormous assessments. This, in turn, could cause enormous market disruption. In short, the Florida Hurricane Catastrophe Fund is a serious, clear and present threat to the stability of the insurance market in Florida. Because of Florida's status as a peak risk state, a collapse there could have vast economic implications. Thus, the Florida Hurricane Catastrophe Fund and any similar entities that might be created in the future deserve careful monitoring, as well as review of the regulations that lead to their creation.

These risks are not necessarily limited to Florida or residual market mechanisms that face management challenges. Regulations related to insurance may also result in a situation in California's market worthy of further investigation. Largely because Fannie Mae and Freddie Mac have never included a requirement for earthquake insurance coverage in their definitions of conforming mortgages, earthquake-prone markets like California are marked by high rates of uninsurance. A January 2009 report by reinsurance broker Aon Benfield[11] found that approximately 86% of Californian homeowners did not have earthquake coverage, and the overwhelming majority of those who did had coverage through the quasi-public California Earthquake Authority. Unlike some other residual market mechanisms, CEA has maintained a good historical track record of appropriate pricing and underwriting practices, which unfortunately also has contributed to the relatively small take-up penetration. A major California earthquake, Aon Benfield concluded, could lead to widespread mortgage defaults.[12]

In this context, we urge that FIO investigate the manner in which overly large residual market mechanisms and state-run reinsurance entities result from burdensome, unnecessary, and outdated modes of insurance rate regulation.

6. International coordination of insurance regulation

One of the most important roles for the Federal Insurance Office laid out in the Dodd-Frank Act is to serve as representative to the International Association of Insurance Supervisors. Established in 1994, the IAIS includes regulatory representatives from roughly 140 countries, including state insurance commissioners from the United States.

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[10] Reuters. "California Completes Largest Municipal Bond Sale in U.S. History," http://www.allbusiness.com/finance-insurance/373082-1.html

[11] Aon Benfield, "Annual Global Climate and Catastrophe Report: 2008"

[12] Ibid.

The markets represented in the association combine to account for 97% of global insurance premiums.

Dialogue among IAIS members has produced the consensus that traditional insurance activities do not give rise to systemic risk.[13] This is a crucial conclusion, as the IAIS is tasked with developing the Insurance Core Principles that serve as the basis of the International Monetary Fund's Financial Sector Assessment Program. We would urge the FIO to underscore this conclusion, and to share it with the G-20's Financial Stability Board, which is expected to complete its work on the insurance portion of the systemically important financial institutions designation process by June 2012.

In that vein, we would like to assert our own view that the business of international reinsurance also does not pose systemic risk and is best regulated by the interactions of market players.

The business of reinsurance, particularly on the international level, is one of the most stable and self-regulated among major industries. Although there exists no universal database of reinsurer insolvencies, an extensive search uncovered only two reinsurance interests—the UK's Global General Reinsurance and Illinois-based Reinsurance Company of America—that have become insolvent and entered into court-ordered, regulator-supervised liquidation processes in the past decade.[14] The first had assets and debts of roughly $100 million and the second, despite its name, did most of its business as an excess and surplus lines primary insurer.[15] Other reinsurers have failed, but they were engaged in orderly wind-downs or run-offs of their operations.

Reinsurance is entirely a business-to-business product that is purchased directly by large sophisticated insurers or placed through large reinsurance brokers on behalf of smaller primary insurance clients. Whether purchased directly or through a broking intermediary, these are parties with tremendous monopsony power with respect to reinsurers.
The information asymmetries that characterize consumer financial products simply do not exist in the international reinsurance market. The sophistication and due diligence of reinsurance counterparties self-enforces stability, and the regulation of both U.S. and

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[13] International Association of Insurance Supervisors, "Position Statement on Key Financial Stability Issues," June 4, 2010, http://www.iaisweb.org/__temp/IAIS_Position_Statement_on_Key_Financial_Stability_Issues.pdf.

[14] For information on Reinsurance Company of America, see Office of the Special Deputy Receiver (Illinois), "Reinsurance Company of America," http://www.osdchi.com/open/rca.htm. For information on Global General Re see Tiffany Kary. "Global General Files for Chapter 15 Bankruptcy in the U.S.," http://www.businessweek.com/news/2011-01-31/global-general-files-chapter-15-bankruptcy-in-u-s-.html

[15] Ibid.

major foreign reinsurers further ensures solvency, appropriate risk management, and conservative investment portfolios. Reinsurers face no risk of a "run on the bank."

As with primary property and casualty insurers, reinsurers also operate in a market marked by a high degree of substitutability. All reinsurers of any size operate on a global scale. Thus, even if an unprecedented collapse of a large reinsurer were to take place, its impacts on the reinsurance marketplace globally would be diffused around the world. The industry has faced several capital-depleting events in recent decades, including Hurricanes Andrew and Katrina and the Sept. 11, 2001 terrorist attacks. Each time, the global market has responded by capitalizing fresh reinsurance entries and alternative risk transfer mechanisms such as catastrophe bonds, captive reinsurers, and sidecars. Even in recent years, which have seen major catastrophes such as the Japanese and New Zealand earthquakes coincide with record-low investment returns, the global reinsurance market has remained stable and solvent.

7. **The costs and benefits of potential federal regulation of insurance across various lines of insurance (except health insurance)**

In the interest of promoting greater uniformity in state insurance regulation, there long have been proposals for federal intervention or direct federal regulation of the industry. While we believe several federal legislative options deserve further study, given the enormity of changes wrought by the Dodd-Frank Act, none should be implemented until the full consequences of financial reforms already in statute become more apparent.

One potential option worthy of study is the optional federal charter. This proposal, which we have supported in the past but do not believe would be wise at any point in the near future, would grant life and P&C insurers and insurance brokers the opportunity to charter at the federal level, in a manner similar to that extended to banks through the Office of Comptroller of the Currency, with all solvency, market conduct, form and rate filings, and licensing overseen by a new federal regulator. Given the enormous changes in financial regulations in the offing as a result of Dodd-Frank, as well as the challenge the FIO itself faces in defining its role, an OFC is, at this time, premature, unnecessary, and likely to have negative consequences.

A more modest alternative with some of the same benefits and detriments as an OFC would be a "federal standards" approach, such as that set forth by former Reps. Mike Oxley and Richard Baker in the draft State Modernization and Regulatory Transformation Act. Under such an approach, the federal government would promulgate national standards covering such areas as insurer and agent licensing, life settlements, receivership, fraud, and regulation of life, commercial P&C, personal lines P&C, and reinsurance. States would then have a period of time in which they could draft statutes to comply with the standards or otherwise risk having their state laws preempted by the federal government. An approach similar to the SMART Act was drafted by FIO Director Michael McRaith when he was still a member of the NAIC. Under this approach, the National Insurance Supervisory Commission would place states themselves in the role of identifying and developing standards for uniformity. States would then have

a limited period of time to adopt rules promulgated by the commission, with the FIO empowered to preempt states who failed to do so. These approaches, unlike an OFC, should be considered in the shorter term.

Another possible approach to address the most onerous of state-level regulations – price controls that prevent insurers from establishing rate and underwriting standards without prior approval – would be to revisit the limited exemption from federal antitrust authority granted to the business of insurance under the McCarran-Ferguson Act. McCarran-Ferguson was passed at a time when virtually all insurance rates and forms were established collectively by industry-owned rating bureaus. States were granted jurisdiction over rates and forms submitted by these bureaus to stave off anticompetitive collusion and to ensure that rates were neither excessive nor insufficient.

The structure of the industry has changed dramatically in the nearly 70 years since McCarran-Ferguson's passage. The rating bureaus, for the most part, are no longer owned by the industry, and many large insurers now establish rates using proprietary formulas that are independent of rating bureau recommendations. With these dramatic changes in the business practices of insurance companies, it may be fair to ask whether the regulatory justification for rate controls still holds. State rate controls persist, but in practice, they are often used not to weed out anticompetitive behavior but to stifle competition and suppress rates, particularly politically unpopular rate increases. One alternative would be to preempt state rating and underwriting regulations and subject insurance rate-making to the full force of federal antitrust scrutiny, provided that safe harbor is granted for smaller insurers to pool claims data for rate-making purposes. So long as rates are competitive, risk-based, and not discriminatory against protected classes of consumers, there is no good justification for suppression of rates, while there are long-term risks that such suppression can negatively impact solvency.

We think each of these approaches merits further study, and we think there already is potential for some very limited and proscribed federal intervention that could promote greater harmony in insurance regulation. One such example could be through establishment of the long-proposed National Association of Registered Agents and Brokers, which would serve as a self-regulatory organization to establish licensing and continuing education standards for insurance producers nationwide, while also allowing producers the opportunity to conduct business in any state.

We also think states can and should explore the option of interstate compacts, such as the Interstate Insurance Product Regulation Commission, which has succeeded in bringing greater uniformity and speed-to-market in the area of life insurance product approvals. An obvious current example where an interstate compact would appear useful is in implementation of the surplus lines provisions of the Nonadmitted and Reinsurance Reform Act, which passed as a part of Dodd-Frank. Though the law encouraged states to form an interstate compact to manage collection and allocation of surplus lines premium taxes for multi-state risks, it did not require that they do so. Early reports suggest the piecemeal approach states have taken to implement the law risks imposing even more

onerous regulatory and reporting burdens on excess and surplus lines brokers and insurers than the ones the NRRA was crafted to alleviate.

However, while there may be cases where limited and proscribed federal intervention might prove useful, we would caution against establishment of a new federal regulatory authority for insurance in the immediate future. Although the insurance industry made it through the financial crisis in relatively strong condition, and the Dodd-Frank Act goes to great lengths to exempt insurers from a number of provisions imposed on banks and other financial institutions, the industry is still processing the impact of the law (as well as, in some cases, provisions of the Patient Protection and Affordable Care Act). Areas that remain of interest to some in the industry include: The Financial Stability Oversight Council's designation system for systemically important financial institutions; the FDIC's resolution authority and any potential assessments that could be laid on financial institutions to resolve a systemically important firm; regulation of derivatives, including establishing definitions of major swaps participants and major swaps dealers; impact of the so-called "Volcker Rule"; establishment of the Federal Insurance Office; implementation of the Nonadmitted and Reinsurance Reform Act; and transition of thrift holding companies to oversight by the Federal Reserve Board.

Given the great uncertainty that surrounds the future path of financial regulation, it would be premature to impose on the industry a new federal regulatory authority. We encourage continued study of federal regulatory options, including those that might preempt destructive rate controls at the state level. However, until the full impact of the most recent round of financial regulatory reform has been fully digested, there will not be any clarity on what impact further intervention – or even worse, dual regulation by both state and federal agencies – might have on insurance markets. As such, we believe that significant reforms should only be made after very significant further study.

Conclusions

We again thank the office for the opportunity to submit public comments. The FIO has critical tasks before it. The right decisions can bring enormous benefits to the public. The wrong ones could have serious negative consequences.

Respectfully submitted,

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