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The Development of International Norms for Insurance Regulation

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THE DEVELOPMENT OF INTERNATIONAL NORMS FOR INSURANCE REGULATION

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ABSTRACT

The development of international norms for insurance has not progressed as far or as deeply as the development of international norms for banking. Several factors have affected this process. First, the efforts to develop such norms are relatively new. The International Association of Insurance Supervisors ("IAIS") has existed for less than fifteen years while the Basel Committee on Banking Supervision has existed for over thirty years. Second, the membership of the IAIS makes it harder for that organization to achieve consensus on principles and standards than for the Basel Committee. The IAIS has members from almost 140 nations, including both developed and less developed nations, while the Basel Committee is comprised of only thirteen members from only developed nations.

Finally, the fact that insurance is regulated by the states within the United States has hindered the ability of the United States to conduct effective international negotiations on insurance regulation. The individual states have not adopted uniform insurance laws. As a result, they do not necessarily espouse the same positions when participating in international bodies like the IAIS. In addition, the federal government has difficulty translating the soft law standards developed by the IAIS into hard law in treaties and international agreements because it currently lacks the power to force the states to change their insurance laws to conform to the negotiated standards. The states also cannot translate the soft law standards developed by the IAIS into hard international laws because they currently are not authorized to conduct negotiations for treaties or binding international agreements on insurance. Until the United States creates a body capable of conducting international negotiations that can bind the states, the development of international insurance standards will continue to proceed more slowly than the development of standards for other financial services sectors.

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INTRODUCTION

The development of international norms and standards for many types of insurance is a relatively new phenomenon when compared with the development of international norms and standards for other commercial activities, such as trade in goods or banking. This is perhaps because many types of insurance were considered to be governed primarily by local, rather than international, conditions. Life insurance, property and casualty insurance, and health insurance comprise the largest sectors within insurance based on premiums. In each case, local laws and local conditions have a significant impact on shaping the risks insured against by insurance firms. The local character of insurance markets has been the major justification as to why insurance is regulated almost exclusively by the states within the United States, rather than by the federal government.

Nevertheless, a number of factors are putting increasing pressure on governments and market participants to develop international norms and standards for insurance. First, financial services[1] markets are increasingly interconnected which means that the risks posed by one region or sector can more easily spill out and affect other regions and sectors. This interconnectedness is due, in part, to the increasing number of fungible financial products and services. Hybrid products that contain elements of traditional banking, securities, or insurance products are being created more frequently now than ever before. These products are breaking down the distinctions among the banking, securities, and insurance sectors. The result is that financial services now form a continuum, rather than distinct silos, for banking, insurance, and securities.

Financial products also are linking previously separate sectors as products from one sector are repackaged to spread and diversify the risks. The current financial crisis has highlighted this fact as mortgages, a traditional banking product, were sold to special purpose vehicles ("SPVs") that bundled them together and issued securities that would pay based on the income stream generated by the mortgage payments. The risk that

1. In this Article, financial services refers to any activity considered financial in nature pursuant to section 103 of the Gramm-Leach-Bliley Act of 1999 ("GLBA"), including banking, securities, merchant banking, and insurance products and services. Gramm-Leach-Bliley Act § 103, 12 U.S.C. § 1843 (1999). This definition of financial services is not universally applied by other organizations. For example, the Basel II Capital Accord excludes insurance activities from the definition of "financial activities" and excludes insurance entities from the definition of "financial entities." BANK FOR INT'L SETTLEMENTS, BASEL COMM. ON BANKING SUPERVISION, INTERNATIONAL CONVERGENCE OF CAPITAL MEASUREMENT AND CAPITAL STANDARDS: A REVISED FRAMEWORK 7 n.5 (2004), *available at* http://www.bis.org/publ/bcbs118.pdf.

those securities would default was insured against either by the SPV taking out bond insurance on the securities or by the purchasers entering into credit default swaps.

Second, technology is also making it easier to purchase products and services from distant suppliers. Insurance companies already use e-mail and blogs to sell their products.[2] Insurance marketing consulting firms, like IdeaStar Inc., are encouraging insurance firms to consider how to market their products using Facebook, Linkedin, Twitter, and YouTube, all of which reach a global audience.[3] Insurance publications discuss other ways that insurance firms can expand their online traffic, such as using search engine optimization techniques to improve their search engine rankings and contracting with related websites for fees generated by users of those sites clicking through to the insurance companies' websites.[4] In addition, the Internet allows individual consumers to compare the prices and products of insurance companies from around the world. All of these developments are weakening the ties that traditionally made insurance a financial product dominated by local or regional concerns.

Third, as the markets in the United States and the European Union mature, the multinational insurance and financial conglomerates are expanding their operations in emerging markets and ratcheting up the global competition for market shares in insurance. The European Union comprised thirty-seven percent of the worldwide life, property, and casualty insurance premiums in 2007, while the United States comprised thirty-two percent.[5] The areas showing the largest potential for growth in the near future are nations in Asia, other than Japan, and Latin America.[6]

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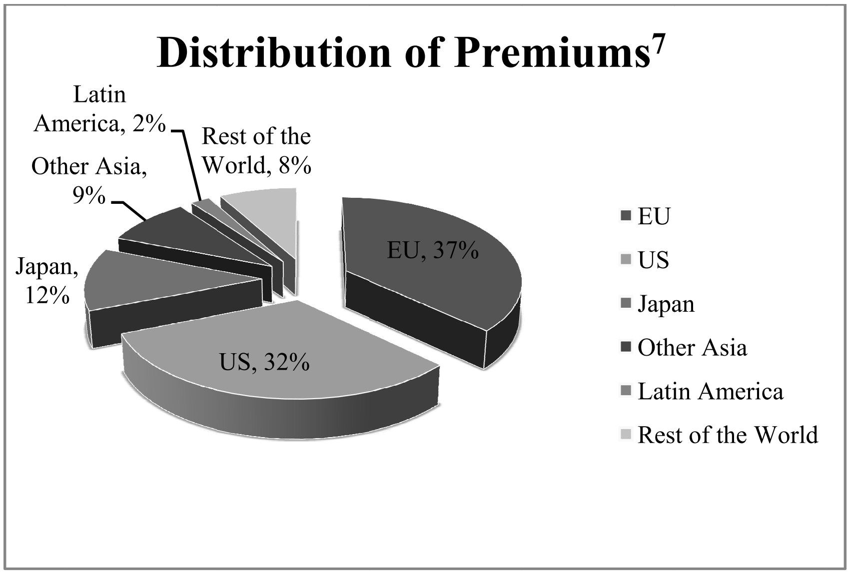
2. For example, Insurance Broadcasting provides a directory of insurance blogs, including a number of blogs associated with insurance businesses. *See* Insurance Broadcasting, Insurance Blog Directory, http://insuranceblogdirectory.com/?gclid=CJXT-bLgvpkCFQXGsgod0XX-5Q (last visited Apr. 18, 2009).

3. *See* IdeaStar, *Insurance Affinity Marketing Strategies and the Decline of Snail Mail*, Mar. 23, 2009, http://www.insurance-technologies.com/News/decline-of-snail-mail.aspx.

4. Al Slavin, *Contact Me . . . If You Can*, BEST'S REV., Mar. 2009, at 26, 27.

5. John A. Cooke & Harold D. Skipper, An Evaluation of the US Insurance Regulation in a Competitive World Insurance Market 3 (June 27, 2008) (unpublished manuscript, presented at AEI Conference: The Future of Insurance Regulation, *available at* http://www.rmi.gsu.edu/insurance_regulation/rel_papers/CookeSkipper_RegulationInternational.pdf).

6. *Id*. at 4.



These factors have encouraged the development of international standards for insurance regulation. For the most part, these standards have taken the form of nonbinding norms, or soft law, rather than binding treaty obligations, or hard law. This Article will examine what the sources are for international insurance norms; why the U.S. regulatory structure acts as an impediment to converting soft law international insurance regulation standards into hard law in the form of binding international agreements; and what the possible solutions to this problem are.

I. Sources of International Insurance Norms

International norms can be developed in one of three ways. De jure standard setting can be developed through treaties, like the General Agreement on Trade in Services ("GATS"), or other binding international agreements.[8] These efforts usually involve a national government imposing a common standard on subnational actors. Alternatively, de facto standard setting can arise when individual governments adopt similar laws without engaging in any coordination or cooperative activities with one another.[9] The common features of these laws emerge because they

7. *Id.* at 4 & fig.1.

8. *See* Robert B. Ahdieh, *Foreign Affairs, International Law, and the New Federalism: Lessons from Coordination* 25 (Emory Univ. Law & Econ. Research Paper No. 08-30; Emory Univ. Pub. Law Research Paper No. 08-43; Princeton Univ. Law & Pub. Affairs Working Paper No. 08-008; Columbia Univ. Law Sch. Pub. Law Research Paper No. 08-184, 2008), *available at* http://ssrn.com/abstract=1272967.

9. *See id*.

are attempting to address the same sorts of problems. Insurance laws around the world tend to incorporate regulations that address both prudential and market conduct risks.[10] As a result, they tend to have similar features, although they can still vary greatly. Finally, group or committee standard setting can result in soft law, such as nonbinding principles or guidelines, developed by intergovernmental forums like the IAIS or industry groups like the International Union of Credit and Investment Insurers.[11]

The way the United States regulates insurance has proven to be a significant impediment to the development of hard international law in that area. The states within the United States are the main insurance regulators. They, however, lack the authority under the U.S. Constitution to negotiate binding international agreements on insurance.[12] The federal government, which has the authority under the U.S. Constitution to negotiate such agreements,[13] has no agency tasked with regulating insurance that could conduct such negotiations. The U.S. Trade Representative's Office, which negotiated GATS, lacks the authority to bind the states and to ensure that they will enact the necessary domestic laws to codify any concession that it might make.[14] As a result, the international agreements on insurance negotiated to date contain substantial exemptions for U.S. states' insurance laws.[15] The breadth of these exemptions means that, in many cases, the principles embodied in GATS and other trade agreements are not binding on the states within the United States and the extent to which the states meet these principles is more a function of soft law rather than hard law.

A number of international forums currently promote the development of soft law international norms in the area of insurance. The primary forum is the IAIS, which has over 190 members (including the insurance commissions from all fifty states within the United States). The Joint Forum, which is comprised of the IAIS, the Basel Committee on Bank Supervision ("Basel Committee"), and the International Organization of Securities Commissions ("IOSCO"), sets guidelines for issues that are common to banking, securities, and insurance, such as the regulation of

10. Cooke & Skipper, *supra* note 5, at 1–2.

11. *See* Ahdieh, *supra* note 8, at 25–26.

12. The U.S. Constitution gives Congress the power to regulate commerce with foreign powers and prohibits the states from negotiating international agreements with foreign powers without the consent of Congress. U.S. CONST. art. I, §§ 8, 10.

13. *Id.* art. I, § 8.

14. Cooke & Skipper, *supra* note 5, at 18.

15. *Id*. at 18–19 & n.27.

financial conglomerates.[16] Some hybrid products, like variable annuities, are regulated by both insurance and securities regulators.[17] As a result, the activities of IOSCO have an impact on the development of regulatory standards for some insurance products.[18]

The IAIS, IOSCO, and the Basel Committee are also members of the Financial Stability Forum ("FSF"), which brings together the national financial supervisory authorities in order "to assess vulnerabilities affecting the international financial system; to identify and oversee action needed to address these; and to improve co-ordination and information exchange among the various authorities responsible for financial stability."[19] Among other things, the FSF promotes the implementation of international standards by national financial supervisory authorities, including those governing insurance.[20] On April 2, 2009, the membership of the FSF was expanded to include Spain and the European Commission, and the FSF was renamed the Financial Stability Board ("FSB").[21] In addition, the FSB's mandate grew to include, among other things, undertaking strategic reviews of the policy development work being done by IAIS, IOSCO, and the Basel Committee, setting guidelines for creating international "supervisory colleges" to monitor the largest financial services firms, and assisting the IMF on Early Warning Exercises concerning financial crises.[22]

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16. Press Release, IOSCO, Joint Forum—Amplified Mandate (June 14, 2002), *available at* http://www.iosco.org/news/pdf/IOSCONEWS3.pdf; IOSCO Joint Forum, http://www.iosco.org/joint_forum/ (last visited Apr. 18, 2009).

17. *See* VARIABLE ANNUITY MODEL REGULATION § 4 (Nat'l Ass'n of Ins. Comm'rs 1996) (discussing procedures for separate accounts); Press Release, SEC, SEC and NASD Release Joint Staff Report on Broker-Dealer Sales of Variable Insurance Products (June 9, 2004), *available at* http://www.sec.gov/news/press/2004-80.htm.

18. For example, IOSCO issued a lengthy report on international derivatives regulation. INT'L ORG. OF SEC. COMM'NS, REPORT ON THE INTERNATIONAL REGULATION OF DERIVATIVE MARKETS, PRODUCTS AND FINANCIAL INTERMEDIARIES (1996), *available at* http://www.iosco.org/library/pubdocs/pdf/IOSCOPD65.pdf.

19. Financial Stability Forum—Mandate, http://www.fsforum.org/about/mandate.htm (last visited Apr. 18, 2009); Financial Stability Forum—Overview, http://www.fsforum.org/about/overview.htm (last visited Apr. 18, 2009).

20. *See* Financial Stability Forum, http://www.fsforum.org/ (last visited Apr. 18, 2009). For a list of members of the FSF, see Financial Stability Forum—Overview, *supra* note 19.

21. Press Release, Fin. Stability Forum, Financial Stability Forum Re-established as the Financial Stability Board 1 (Apr. 2, 2009), *available at* http://www.fsforum.org/press/pr_090402b.pdf.

22. *Id.* at 2; Elena Moya, *Financial Stability Board: How It Will Work*, GUARDIAN, Apr. 4, 2009, http://www.guardian.co.uk/world/2009/apr/04/financial-stability-board-g20.

The Organisation for Economic Co-operation and Development ("OECD") promotes insurance regulation standards through its Insurance and Private Pensions Committee.[23] The OECD has adopted the Code of Liberalization of Current Invisible Operations ("Invisibles Code").[24] This code deals with standards for the intangible trade in insurance, securities, banking, and investments.[25] The International Actuarial Association ("IAA") and International Accounting Standards Board ("IASB") play roles by developing the actuarial and accounting standards for insurance firms and products.[26]

In order to illustrate the impact that international organizations can have on the development of insurance norms, this Article will examine the roles played by GATS and other trade agreements, the IAIS, and the developing EU directives on insurance.

A. General Agreement on Trade in Services and Other Trade Agreements

The desire of multinational insurance companies and other financial services firms to access markets overseas led to the inclusion of services in international trade negotiations since the 1980s.[27] The United States first addressed services in its Free Trade Agreement with Israel in 1985 by including a nonbinding declaration on the need to develop national

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23. OECD, Directorate for Financial and Enterprise Affairs, Insurance: About, http://www.oecd.org/about/0,3347,en_2649_34851_1_1_1_1_1,00.html (last visited Apr. 18, 2009).

24. Org. for Econ. Co-operation & Dev. [OECD], *Code for Liberalisation of Current Invisible Operations* (2008), *available at* http://www.oecd.org/dataoecd/41/21/2030182.pdf. The Invisibles Code articulates several principles, including the right of establishment of insurance, the right to provide services cross-border, and an individual's right to buy insurance from any company. *See id.* annex A, app. to annex I, annex II. It also contains exceptions to preserve public order and security. *Id.* art. 3. The United States also has an exemption for any "action by a State of the United States which comes within the jurisdiction of that State." *Id.* annex C. This exemption basically excludes state regulation of insurance from compliance with this code.

25. *See id*. annex A (providing a detailed list of operations covered by the Invisibles Code).

26. About the IAA, Who Are We?, http://www.actuaries.org/index.cfm?LANG=EN&DSP=ABOUT&ACT=WHO (last visited Apr. 18, 2009); IASB—Insurance Contracts, http://www.iasb.org/Current+Projects/IASB+Projects/Insurance+Contracts/Insurance+Contracts.htm (last visited Apr. 18, 2009).

27. *See* Kern Alexander, *The GATS and Financial Services: Liberalisation and Regulation in Global Financial Markets*, *in* THE WORLD TRADE ORGANIZATION AND TRADE IN SERVICES 561, 564, 568 (Kern Alexander & Mads Andenas eds., 2008) (discussing that, in response to banking crises, international financial institutions sought to promote not only market access, but also greater financial stability through trade negotiations).

treatment and market access in the trade in services.[28] The Uruguay Round of the General Agreement on Tariffs and Trade ("GATT") was the first attempt to negotiate a multilateral agreement on services and resulted in GATS.[29]

All of the 153 members of the World Trade Organization ("WTO") are signatories to GATS.[30] In addition, nations around the world have entered into a variety of free trade agreements, like the North American Free Trade Agreement ("NAFTA").[31] GATS and the free trade agreements are built on four principles that were originally developed to deal with the trade in goods under GATT: (1) national treatment, (2) most-favored-nation status, (3) market access, and (4) transparency. National treatment requires that domestic rules ensure that foreign suppliers receive treatment no less favorable than domestic suppliers.[32] Most-favored-nation ("MFN") status prohibits one country's suppliers from being accorded treatment more favorable than any other nation's suppliers.[33] Market access requires that nations guarantee the right of a foreign supplier to enter the market.[34] Finally, transparency requires that rules regarding market access and the domestic operation of an insurance company be clear, ascertainable, and openly administered.[35] GATS does not address principles or standards for prudential regulations, market conduct regulations, or systemic regulations for insurance.[36]

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28. Free Trade Agreement, Isr.-U.S., Apr. 22, 1985, 24 I.L.M. 653, 679–80 (1985).

29. Alexander, *supra* note 27, at 567–69.

30. WTO: Understanding the WTO—Members, http://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm (listing the 153 WTO Members). *See also* Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, ¶ 4, Apr. 15, 1994, 33 I.L.M. 1125 (1994) (stating that, but for plurilateral agreements, the WTO Agreement is "open for acceptance as a whole," including GATS).

31. North American Free Trade Agreement, U.S.-Can.-Mex., Dec. 17, 1992, 32 I.L.M. 289 (1993); John Cooke, *Alternative Approaches to Financial Services Liberalisation: The Role of Regional Trade Agreements*, *in* THE WORLD TRADE ORGANIZATION AND TRADE IN SERVICES, *supra* note 27, at 615, 615–34.

32. General Agreement on Trade in Services art. XVII, Apr. 15, 1994, 33 I.L.M. 1167 [hereinafter GATS].

33. *Id.* art. II.

34. *Id.* art. XVI.

35. *See id.* art. III.

36. In fact, one of the major exceptions to the applicability of the four GATS principles is the prudential carve-out, which allows nations to adopt regulations that violate one or more of the four GATS principles in order to maintain the solvency of the insurance industry. For a history of the prudential carve-out, see generally Wei Wang, *The Prudential Carve-out*, *in* THE WORLD TRADE ORGANIZATION AND TRADE IN SERVICES, *supra* note 27, at 601, 601–04.

GATS and the free trade agreements allow nations to continue to apply laws or regulations that conflict with one or more of the four basic principles if these laws or regulations fit within one of the following eight exceptions: (1) laws necessary to protect public morals or maintain public order;[37] (2) laws necessary to protect human, animal, or plant life or health;[38] (3) laws necessary to secure compliance with other laws or regulations;[39] (4) laws inconsistent with national treatment provided that the difference in treatment is aimed at ensuring the equitable or effective imposition or collection of direct taxes with respect to foreign services or service suppliers;[40] (5) laws inconsistent with MFN treatment, provided the difference in treatment is the result of an agreement on the avoidance of double taxation;[41] (6) government programs not supplied on a commercial basis or in competition with the private sector (e.g., health insurance or unemployment insurance);[42] (7) prudential measures needed to protect investors, policyholders, or others to whom a fiduciary duty is owed, or needed to stabilize the financial system;[43] and (8) express reservations set forth in schedules that do not conform to the obligations set forth in GATS.[44] The breadth of these exceptions can swallow the GATS principles. Consequentially, whether a nation or state within the United States complies with these GATS principles may be a matter of soft law rather than hard law. For example, the United States has express reservations for many state regulations on insurance in a schedule to GATS.[45] As a result, a number of state regulations violate the GATS principles of national treatment, market access, and transparency.[46] However, there does not appear to be any inconsistencies between state regulations and MFN status.[47]

State laws that are inconsistent with the principle of national treatment include reinsurance cessions that differently affect domestic and out-of-

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37. GATS, *supra* note 32, art. XIV.
38. *Id*.
39. *Id.*
40. *Id.*
41. *Id.*
42. *Id.* art. XIII.
43. *Id.* Annex on Financial Services, ¶ 2(a).
44. *See id.* arts. XX–XXI.
45. The World Trade Organization provides a list of U.S. limitations on market access and national treatment in the area of insurance in its Trade in Services Database, http://tsdb.wto.org/Default.aspx (select "07.A. All Insurance and Insurance-related Services" from "Jump to a specific sector for a given Member" drop-down menu; then select "USA" from "Choose Member" menu; then click "go") (last visited Apr. 18, 2009).
46. Cooke & Skipper, *supra* note 5, at 7–16.
47. *Id.* at 14.

state insurers, domestic preference tax laws, and credit for reinsurance and collateralization.[48] These collateralization obligations are particularly problematic when one considers that the United States accounts for almost half of the total reinsurance premiums worldwide.[49] About thirty-eight percent of all ceded reinsurance premiums worldwide are subject to the U.S. states' requirements for collateral.[50]

The states also have a number of laws or programs at odds with the GATS principle of market access. These include the sheer number and variety of insurer licensing requirements, state monopoly insurers such as Minnesota's workers' compensation reinsurer, government owned or sponsored insurers, compulsory or restrictive reinsurance cessions, extra-territorial application of state laws, barriers to exit, domestic preference tax laws, and citizenship/residency requirements.[51] While the states' laws governing insurance facially meet the GATS standard of transparency, the large number and complexity of the insurance regulations in the fifty states can make the U.S. market opaque for foreign companies seeking to enter it.[52]

In addition to these bilateral and multilateral trade agreements, the insurance supervisors of a number of nations have signed memoranda of understanding ("MOUs") with each other. By their nature, MOUs are a form of soft law as they usually encourage cooperation without imposing any legally enforceable obligations on either party.[53] The National Association of Insurance Commissioners ("NAIC"), the coordinating organization for the state insurance commissioners within the United States, has signed MOUs regarding regulatory cooperation with the Association of Latin American Insurance Supervisors, Brazil, China, Egypt, Hong Kong, Iraq, Korea, Russia, Thailand, and Vietnam.[54] While the NAIC can provide technical assistance on insurance regulation to other nations,

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48. *Id*. at 14–16.
49. *Id*. at 16.
50. *Id*.
51. *Id.* at 8–16.
52. *Id*. at 16.
53. *See* John H. McNeill, *International Agreements: Recent U.S.-U.K. Practice Concerning the Memorandum of Understanding*, 88 AM. J. INT'L L. 821, 822 (1994).
54. Press Release, Nat'l Ass'n of Ins. Comm'rs, NAIC Signs MOU with Thailand: Agreement Enhances Regulatory Cooperation with Southeast Asia (June 1, 2008), *available at* http://www.naic.org/Releases/2008_docs/mou_thailand.htm. The language of these MOUs does not provide for any enforcement mechanism should one side or the other fail to cooperate. For example, see Memorandum of Understanding Between the Office of the Insurance Commission, Thailand and the National Association of Insurance Commissioners of the United States of America, *available at* http://www.naic.org/documents/govt_rel_mou_thailand.pdf.

it does not have the authority to bind any of the states in international negotiations on insurance standards. State insurance regulators in the United States are typically not authorized by state legislatures to engage in promoting global regulatory cooperation and might face criticism for wasting state money if they spend significant time on such activities.[55]

B. International Association of Insurance Supervisors

The IAIS is the primary international organization that promotes insurance regulatory standards. Compared to the Basel Committee and IOSCO, the IAIS is a relatively new organization. It was founded in 1994, while the Basel Committee and IOSCO are outgrowths of organizations formed in 1974.[56] The IAIS has over 190 members from about 140 countries.[57] It has such a large membership because the NAIC and each of the insurance regulators from the fifty-six U.S. jurisdictions are members.[58]

Not every nation in the world is a member of the IAIS. Insurance supervisors that "underwrite, sell or otherwise provide insurance" are not eligible for membership in IAIS.[59] In addition, some Islamic nations have developed a regulatory regime for insurance that attempts to bring insurance products into conformity with the requirements of Islamic law.[60] Islamic law prohibits the charging of interest (*riba*), contracts involving risk or uncertainty because one or more of the terms is undefined (*gharar*), and gambling or speculation (*maīsir*).[61] The requirements of Islamic law make it difficult to comply with the standards for conventional insurance being developed by the IAIS. Such differences may explain why

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55. Cooke & Skipper, *supra* note 5, at 19.

56. About IOSCO, http://www.iosco.org/about/index.cfm?section=history (last visited Apr. 18, 2009); History of the Basel Committee and Its Membership, http://www.bis.org/bcbs/history.htm (last visited Apr. 18, 2009); IAIS—About the IAIS, http://www.iaisweb.org/index.cfm?pageID=28 (last visited Apr. 18, 2009).

57. INT'L ASS'N OF INS. SUPERVISORS, ANNUAL REPORT 2007–08 at iii, *available at* http://www.iaisweb.org/__temp/2007-2008_Annual_report.pdf.

58. Each of the fifty states, the District of Columbia, and each U.S. territory is a member of the IAIS. *See* IAIS Members, http://www.iaisweb.org/index.cfm?pageID=31 (last visited Mar. 16, 2009) (noting that the "NAIC [and fifty-six] jurisdictions" in the United States are IAIS members).

59. Int'l Ass'n of Ins. Supervisors [IAIS], *By-laws*, art. 6(2) (2005), *available at* http://www.iaisweb.org/__temp/By-laws_2005_edition.pdf.

60. ALY KHORSHID, ISLAMIC INSURANCE: A MODERN APPROACH TO ISLAMIC BANKING (2004).

61. *Id.* at 42.

several Islamic nations, including Indonesia, Iran, and Yemen, are not members of the IAIS.[62]

The supervisory and regulatory agencies for nations interested in the Islamic financial services industry formed their own international organization in 2002, the Islamic Financial Services Board ("IFSB").[63] The IFSB has 178 members, "includ[ing forty-two] regulatory and supervisory authorities as well as [the] International Monetary Fund, [the] World Bank, [the] Bank for International Settlements," several development banks, and about 130 market participants operating in thirty-four countries.[64] The IFSB sets standards for regulating Islamic financial products, which includes banking and securities products as well as insurance products.[65] Recognizing the need for international cooperation to regulate Islamic insurance providers, the IFSB and the IAIS released a Joint Issues Paper on Issues in Regulation and Supervision of *Takaful* (Islamic Insurance) in June 2006.[66] They recently built on this effort by signing on December 4, 2008, a working agreement to enhance cooperation between the two organizations concerning prudential regulations for entities that provide *takaful*.[67]

The IAIS has issued principles, standards, and guidance papers on a range of insurance regulatory issues, such as capital adequacy, licensing, and financial conglomerates.[68] The principles and standards promulgated by the IAIS must be approved by two-thirds of its members at a general meeting.[69] Because of its large number of members and consensus style of approval for principles and standards, the IAIS principles and standards represent a floor when it comes to insurance regulation.

The Insurance Core Principles ("ICPs"), which focus on prudential requirements, form the central principles promulgated by the IAIS.[70] IAIS members consider the ICPs as roughly equivalent to the standards set for

62. *See* IAIS Members, *supra* note 58.

63. IFSB, About IFSB, http://www.ifsb.org/background.php (last visited Mar. 17, 2009).

64. *Id*.

65. *Id*.

66. Press Release, Islamic Fin. Servs. Bd., IFSB-IAIS Working Agreement Aims to Enhance Cooperation and Understanding in Mutual Areas of Supervision of the *Takaful* Industry (Dec. 4, 2008), *available at* http://www.ifsb.org/preess_full.php?id=101&submit=more.

67. *Id.*

68. IAIS—Overarching Standard Setting Papers, http://www.iaisweb.org/index.cfm?pageID=37 (last visited Mar. 17, 2009).

69. IAIS, *By-laws*, *supra* note 59, art. 12(1).

70. IAIS, *Insurance Core Principles and Methodology* (Oct. 2003), *available at* http://www.iaisweb.org/view/element_href.cfm?src=1/94.pdf.

banks under Basel I and Basel II. Since 2005, the IAIS has produced a series of policy papers to provide guidance to its members regarding how to implement the ICPs.[71]

In 2005, the IAIS adopted two papers that outline a framework for insurance supervision and the cornerstone principles for insurance supervision.[72] This framework divides the supervisory structure into three levels: Level 1—Preconditions; Level 2—Regulatory Requirements; and Level 3—Supervisory Actions.[73] The IAIS identified two preconditions for establishing an effective insurance supervisory framework: (1) an environment that contains "developed and efficient financial market[s]" and an institutional and legal framework for financial services supervision; and (2) "clearly defined principal, supervisory objectives, and . . . a supervisory authority . . . that[] has adequate powers," is independent, is transparent and accountable, has sufficiently trained staff, and handles confidential information appropriately.[74] The IAIS also identified three "regulatory requirements," or areas that need to be regulated by the insurance supervisor. These areas are (1) financial requirements, (2) governance requirements, and (3) market conduct requirements.[75] Finally, the IAIS discussed why supervisory assessment and intervention are critical in order to guarantee that insurers adequately deal with the risks in their portfolios and comply with the regulatory requirements.[76]

One of the goals of the regulatory requirements is to develop a common structure and common standards for insurers' solvency.[77] In 2007, the IAIS published a paper outlining its views on what the common structure for assessing an insurer's solvency ought to be.[78] The common

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71. IAIS—Overarching Standard Setting Papers, *supra* note 68.

72. IAIS, *A New Framework for Insurance Supervision*: *Towards a Common Structure and Common Standards for the Assessment of Insurer Insolvency* (Oct. 2005), *available at* http://www.iaisweb.org/view/element_href.cfm?src=1/87.pdf [herinafter IAIS, *Framework*]; IAIS, *Towards a Common Structure and Common Standards for the Assessment of Insurer Solvency: Cornerstones for the Formulation of Regulatory Financial Requirements* (Oct. 2005), *available at* http://www.iaisweb.org/view/element_href.cfm?src=1/88.pdf.

73. IAIS, *Framework*, *supra* note 72, at 5 fig.1.

74. *Id*. at 5–6.

75. *Id.* at 6. Financial requirements concern the "financial aspects of an insurer's operations" including its capital adequacy and solvency. *Id*. Governance requirements concern "how an insurer is governed." *Id.* Market conduct requirements concern "how an insurer conducts its business and presents itself to the market." *Id*.

76. *Id.* at 7.

77. *Id*.

78. IAIS, *The IAIS Common Structure for the Assessment of Insurer Solvency* (Feb. 2007), *available at* http://www.iaisweb.org/view/element_href.cfm?src=1/85.pdf [hereinafter IAIS, *Structure Paper*].

structure uses a risk-based methodology that includes both quantitative elements for capital adequacy and solvency, as well as qualitative elements for governance, market conduct, and disclosure.[79] The common structure contains fifteen structure elements, which include one structure element at Level 1—Preconditions, twelve structure elements at Level 2—Regulatory Requirements, one structure element at Level 3—Supervisory Actions, and one overarching structure element concerning disclosure.[80] The structure element for Level 1 focuses on the need for the insurance supervisor to have adequate power to make and enforce insurance regulations to assess and manage risks.[81] The structure elements for Level 2 are broken down into financial requirements, market conduct requirements, and governance requirements.[82]

Ten out of the twelve structure elements for Level 2 deal with financial requirements. These elements would require that solvency regulations address all relevant risks, "including underwriting risk, credit risk, market risk, operational risk[,] and liquidity risk."[83] The elements require quantifiable risks to be addressed "in sufficiently risk sensitive regulatory financial requirements."[84] Such requirements should "provide . . . incentives for optimal alignment of risk management by the insurer and [the] regulation."[85] The IAIS does not mandate that insurance supervisors use one method for achieving this goal. Instead, the IAIS Structure Paper notes that insurance supervisors may use any of the following methods:

> • regulatory financial requirements, ranging from sophisticated risk sensitive requirements to simple ratios or even nominal minimum requirements including necessary safety measures
>
> • quantitative limits to risk exposures
>
> • qualitative requirements
>
> • additional quantitative or qualitative requirements arising from supervisory assessment.[86]

Nevertheless, the IAIS envisions the insurer's responsibility as managing risk and the insurance regulator's responsibility as guaranteeing that

79. *Id*. at 4.
80. *Id*. at 5–9.
81. *Id*. at 5.
82. *Id*. at 5–8.
83. *Id*. at 5.
84. *Id*.
85. *Id*.
86. *Id*. at 16.

the insurer meets this obligation.[87] Thus, the IAIS encourages supervisors to require that an insurer "translate its risk exposure as far as practicable into quantitative measures which provide a sound and consistent basis for the setting of premium levels, determining technical provisions and deciding on the economic capital it finds optimal from its risk management perspective."[88] IAIS standards would allow supervisors to give individual insurers a great deal of latitude in terms of assessing and reserving for the risks they face. In fact, the IAIS believes that such risk-sensitive regulatory requirements are preferable to fixed ratios or limits because they provide insurers with better incentives for managing risk, discourage regulatory arbitrage, and enable the better use of resources.[89]

IAIS structure elements for Financial Requirements also encourage insurance supervisors and insurers to use the "total balance sheet approach" when assessing risks.[90] This approach is meant to be consistent with the total balance sheet approach adopted by the IAA.[91] The IAIS's approach "recogni[z]e[s] the interdependence [of an insurer's] assets, liabilities, capital requirements, and capital resources."[92] At a minimum, the IAIS expects the total assets of an insurer minus the total liabilities of an insurer to "exceed the [insurer's] required capital for solvency purposes."[93] The IAIS's structure elements call for basing the valuation of an insurer's assets and liabilities on their current economic value consistent with their current market prices.[94] The IAIS recognizes that all insurance assets and liabilities may not be traded on deep, liquid markets and that mark-to-model methodologies will need to be used to estimate their economic value in those cases.[95]

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87. *Id*. at 14.

88. *Id*.

89. *Id*. at 16–17.

90. *Id*. at 19.

91. The IAA articulated its concept of total balance sheet approach in A Global Framework for Insurer Solvency Assessment, in which it noted: "an insurer's true financial strength for solvency purposes requires appraisal of its total balance sheet on an integrated basis under a system that depends upon realistic values, consistent treatment of both assets and liabilities and does not generate a hidden surplus or deficit." INT'L ACTUARIAL ASS'N, INSURER SOLVENCY ASSESSMENT WORKING PARTY, A GLOBAL FRAMEWORK FOR INSURER SOLVENCY ASSESSMENT (2004), *available at* http://www.actuaries.org/LIBRARY/papers/global_framework_insurer_solvency_assessment-public.pdf.

92. IAIS, *Structure Paper*, *supra* note 78, at 19.

93. *Id.* at 19.

94. *Id*. at 19–20.

95. *Id*. at 20–22.

IAIS rules only require that the risk margin,[96] and not the service margin,[97] be taken into account when calculating technical provisions and other insurance liabilities. This approach conflicts with the approach recommended by the IASB. The IASB expects insurers to measure their liabilities based on three factors:

> (a) explicit, unbiased, market-consistent, probability-weighted and current estimates of the contractual cash flows[;]
>
> (b) current market discount rates that adjust the estimated future cash flows for the time value of money[;]
>
> (c) an explicit and unbiased estimate of the margin that market participants require for bearing risk (a risk margin) and for providing other services, if any (a service margin).[98]

As a result, liabilities for solvency purposes under the IAIS approach are lower than liabilities for accounting purposes under the IASB approach. Many state insurance regulators in the United States require that the service margin also be taken into account when estimating technical provisions and other liabilities. Some in the European Union have opposed including a service margin because they feel that it falls outside of the market value for insurance liabilities.[99] The IAIS standards more closely reflect the European approach rather than the American approach or the IASB approach.

IAIS structure elements provide that capital requirements for an insurer must take into account not only the level of liabilities, including the risk margin for those liabilities, but also asset-liability mismatch risk and volatility risks. For some countries adopting the IAIS standards would result in substantial changes in their solvency regulations for insurance companies. Below is an example of how the valuing of assets and liabilities under a traditional formula-based solvency approach would differ from the market-consistent approach advocated by the IAIS:

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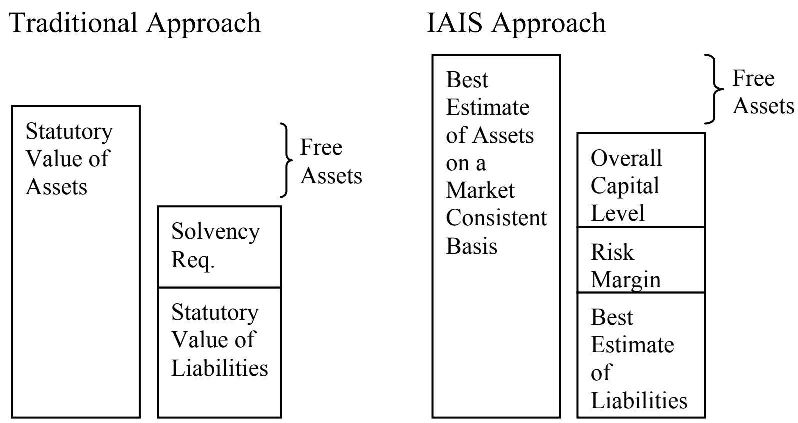
96. Risk margin reflects the estimated margin required for insurers to bear risks.

97. Service margin reflects the estimated margin required for insurers to perform services other than bearing the risk of loss.

98. INT'L ACCOUNTING STANDARDS BD., DISCUSSION PAPER: PRELIMINARY VIEWS ON INSURANCE CONTRACTS 11 (May 2007), *available at* http://www.iasb.org/NR/rdonlyres/08C8BB09-61B7-4BE8-AA39-A1F71F665135/0/InsurancePart1.pdf.

99. The EU Solvency II proposal does not include a service margin when calculating the value of technical provisions and other liabilities.



Most nations around the world do not yet regulate insurance company solvency using the risk-based approach advocated by the IAIS in its Structure Paper. The European Union has proposed a regulatory regime called Solvency II which would be very similar to the one espoused by the IAIS.[100] The states within the United States, however, use a combination of "formula-based minimum reserves and factor-based minimum capital requirements" that have been adjusted in recent years to include some risk-based modeling approaches.[101] The NAIC adopted a Solvency Modernization Initiative Work Plan to examine to what extent U.S. insurance regulations will need to change in response to IAIS principles or other developments around the world, such as the EU Solvency II proposal.[102]

The failure of American International Group ("AIG") and the U.S. investment banks to predict accurately the risks to which they were exposed based on their internal models has raised doubts about the effectiveness of current risk management models, and the use of mark-to-

100. *Solvency II: Setting a Global Standard*, REACTIONS, Jul/Aug 2008. *See also* European Commission, Internal Market, Insurance, Basic Architecture, http://ec.europa.eu/internal_market/insurance/solvency/architecture_en.htm (last visited Apr. 19, 2009) (describing Solvency II).

101. Andrew F. Griffin & Mike Lombardi, *Financial Services: Toward a Global Solvency Standard*, EMPHASIS 2006/2, at 20, *available at* http://www.towersperrin.com/tp/getwebcachedoc?webc=TILL/USA/2006/200605/SolvenyQ2523.pdf.

102. *Solvency II: Setting a Global Standard*, *supra* note 100; NAT'L ASS'N OF INS. COMM'RS, PLEN. SESS. MINUTES NAIC "SOLVENCY MODERNIZATION INITIATIVE" WORK PLAN (June 2, 2008), *available at* http://www.naic.org/documents/committees_e_080903_solvency_2_work_plan.pdf.

market accounting practices.[103] The concerns raised by the current global financial crisis led the G20 Summit to establish two working groups that would deal with issues related to insurance—one to re-evaluate the regulatory requirements for insurers and the other to enhance international cooperation.[104] The IAIS has set up a task force to examine what changes need to be made to deal with international insurers and the special risks they pose, what prudential requirements to impose to deal with contagion effects from failing firms, what regulations should be developed to deal with currently unregulated entities, and how to achieve regulatory consistency with other sectors like banking and securities.[105] As a result of these investigations, IAIS solvency standards and other regulatory standards are likely to be revised in the near future.

C. European Union Directives

The European Union represents the single biggest market for insurance, as it generates thirty-seven percent of the worldwide premiums.[106] As a result, its laws and regulations play a large role in shaping the standards by which insurance companies operate worldwide. The EU is in

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103. Pursuant to the congressional requirement in the Emergency Economic Stabilization Act of 2008, the SEC issued a report in December on the impact of mark-to-market accounting in the current financial crisis. SEC. & EXCH. COMM'N, OFFICE OF THE CHIEF ACCOUNTANT, DIV. ON CORP. FIN., REPORT AND RECOMMENDATIONS PURSUANT TO SECTION 133 OF THE EMERGENCY ECONOMIC STABILIZATION ACT OF 2008: STUDY ON MARK-TO-MARKET ACCOUNTING (Dec. 30, 2008), *available at* http://www.sec.gov/news/studies/2008/marktomarket123008.pdf. This report concluded that mark-to-market accounting had not played a significant role in the current crisis and that the benefits to investors from the transparency provided by mark-to-market accounting outweighed any costs associated with the practice. *Id*. at 7–8. The report did make some recommendations about how fair value and mark-to-market accounting could be improved. *Id*. at 7–10. This report, however, has not halted the ongoing debate about whether mark-to-market accounting contributed to the current financial crisis. Even before the current financial crisis began, some academics raised the possibility that mark-to-market accounting might cause a financial crisis when one would not have occurred using traditional accounting. For example, see Franklin Allen & Elena Carletti, *Mark-to-Market Accounting and Liquidity Pricing* (Fin. Inst. Ctr., Wharton Sch. of Bus., Univ. of Pa., No. 06-15, 2006), *available at* http://fic.wharton.upenn.edu/fic/papers/06/0615.pdf.

104. G20, About G20, http://www.g20.org/about_working_groups.aspx (last visited Apr. 23, 2009) (listing all four working groups). In its response to the G20 Washington Action Plan, the IAIS has identified pertinent "action items" for the insurance industry that the working groups should address. INT'L ASS'N OF INS. SUPERVISORS, IAIS FOLLOW-UP RESPONSE TO THE G20 WASHINGTON ACTION PLAN 1, 7 (Feb. 13, 2009), *available at* http://www.iaisweb.org/__temp/IAIS_follow-up_response_to_G20__February_2009.pdf [hereinafter IAIS FOLLOW-UP RESPONSE].

105. IAIS FOLLOW-UP RESPONSE, *supra* note 104, at 3.

106. Cooke & Skipper, *supra* note 5, at 3.

the process of adopting Solvency II, a new insurance directive defining the framework principles for insurance regulation within the European Union.[107] Implementation of Solvency II involves a four-step process.[108] The first level focuses on the adoption of the primary legislation that will define these framework principles.[109] The second level requires the Commission, with the assistance of a regulatory committee and an advisory committee, to adopt the technical measures for implementing these principles.[110] The third level requires cooperation among the national regulators within the EU to ensure the consistent interpretation of the rules and regulations implementing the framework principles.[111] Finally, the fourth level requires consistent enforcement of the rules.[112]

Like Basel II, Solvency II envisions organizing the framework principles around three pillars.[113] Pillar I would define the financial requirements including the capital adequacy and solvency requirements for insurance firms.[114] Pillar II would define the supervisory activities of each national authority.[115] Pillar III would outline the reporting and public disclosure requirements for insurance firms and supervisory authorities.[116]

As in Basel II and the IAIS solvency structure, Solvency II would redefine the capital adequacy requirements to allow firms to use risk models to more accurately determine their exposure to risk and the capital necessary to maintain their solvency. Solvency II would employ two criteria: the Solvency Capital Requirement ("SCR") and the Minimum Capital Requirement ("MCR").[117] Under the SCR, firms would be allowed to use either a standard form based on different models approved by their national supervisory authority or their own internal models after getting them approved by their national supervisory authority.[118] The MCR

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107. *See* European Commission, Internal Market, Insurance, Solvency and Solvency II, http://ec.europa.eu/internal_market/insurance/solvency/index_en.htm#sol2 (last visited Apr. 18, 2009).

108. UK Financial Services Authority, Solvency 2, http://www.fsa.gov.uk/pages/About/What/International/solvency/index.shtml (last visited Feb. 18, 2009).

109. *Id.*

110. *Id.*

111. *Id.*

112. *Id.*

113. RYM AYADI & CHRISTOPHER O'BRIEN, THE FUTURE OF INSURANCE REGULATION AND SUPERVISION IN THE EU: NEW DEVELOPMENTS, NEW CHALLENGES: FINAL REPORT OF A CEPS TASK FORCE 66–69 (2006).

114. *Id.* at 66–67.

115. *Id.* at 66, 69.

116. *Id.* at 67, 69.

117. *Id.* at 67.

118. *Id.* at 68.

would be set by the national supervisory authorities and would act as a floor in terms of capital adequacy. If a firm fell below the MCR, it would trigger supervisory action.[119] The EU may reconsider which models it will allow firms to use and may set higher MCR standards in the wake of the current financial crisis.

Solvency II will likely influence how insurance regulators outside of the EU regulate insurance, particularly those in the United States. This is due to the fact that many multinational insurance companies operate in the EU and may want the standards that apply in the EU to apply to their global operations. In addition, Solvency II would require that non-EU insurance companies be regulated by a supervisory authority equivalent to the national authorities within the EU in order to allow their capital held outside of the EU to be counted towards meeting their capital requirements under Solvency II.[120] It is unclear at this time if U.S. state regulators would be deemed "equivalent" under Solvency II or to what extent they would have to change their laws and regulations to be deemed "equivalent." Thus, Solvency II may pressure U.S. regulators to adopt the same or similar standards for regulating insurance so that U.S. insurance companies with international operations are not handicapped when they try to compete in the Europe Union.

II. THE U.S. REGULATORY STRUCTURE AS AN OBSTACLE TO DEVELOPING INTERNATIONAL NORMS

As the United States is the largest single national insurance market in the world, the way it regulates insurance has a significant impact on the global standards for insurance regulation. The inability of the Unites States to establish uniform standards domestically hinders its ability to persuade other nations to adopt uniform standards internationally.[121] In addition, the U.S. approach to regulating insurance currently makes it difficult for it to engage in the type of give-and-take necessary to conduct successful international negotiations.[122] To better comprehend why the U.S. regulatory structure hinders the development of international norms, one needs to understand how the United States ended up with its current regulatory structure and the problems with this structure.

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119. *Id*.

120. *Commission Amended Proposal for a Directive of the European Parliament and of the Council on the Taking-up and Pursuit of Business of Insurance and Reinsurance (Solvency II)*, at 26, COM(2008) 119 final (Feb. 26, 2008).

121. Cooke & Skipper, *supra* note 5, at 18–19. *See also id.* at 22–23 (noting that an optional federal charter would help alleviate this problem).

122. *Id*. at 18–19.

A. Brief History of the U.S. Regulatory Structure

Historically, U.S. federal and state governments have regulated financial services primarily based on the institution providing the financial service or product. This type of regulation is referred to as institutional or entity regulation.[123] The states established separate regulators to regulate first banks, then insurance companies, and finally securities firms.

States began regulating insurance during the latter half of the 1800s. The first state board established to regulate insurance was the New Hampshire Board of Insurance Commissioners formed in 1851.[124] "In 1873, [only] twelve states had 'some form of institutionalized insurance regulation'"; by 1905, twenty-two states had such regulation.[125] State insurance regulation during this period was not exactly effective, in part, due to the fact that many administrators were either corrupt, halfhearted, or ineffectual.[126] In addition, no coherent economic theory underlay most insurance regulation. Instead, most regulations were a product of interest group politics, policyholders' fears concerning the economic power of the insurance companies, and a belief that such companies were out to defraud the public.[127]

State regulations have never been completely consistent or uniform. In fact, as the insurance companies expanded across state lines, some within the industry sought federal regulation as a means of supplanting the burden of complying with different state regulations.[128] It was presumed that federal regulation would be weaker than the existing state regulations.[129]

Movement in the direction of federal regulation was halted by the decision of the U.S. Supreme Court in *Paul v. Virginia*,[130] which held that "[i]ssuing a policy of insurance is not a transaction of commerce" and, therefore, the federal government lacked the power to regulate insurance under the Commerce Clause.[131] In 1944, however, the U.S. Supreme Court in *United States v. South-Eastern Underwriters Ass'n* reversed its

123. Elizabeth F. Brown, E Pluribus Unum—*Out of Many, One: Why the United States Needs a Single Financial Services Agency*, 14 U. MIAMI BUS. L. REV. 1, 11 (2005).

124. Susan Randall, *Insurance Regulation in the United States: Regulatory Federalism and the National Association of Insurance Commissioners*, 26 FLA. ST. U.L. REV. 625, 630 n.18 (1999). Many of the first commissions were not independent agencies or entities, but were instead comprised of other state officials with other duties. LAWRENCE M. FRIEDMAN, A HISTORY OF AMERICAN LAW 332 (3d ed., 2005).

125. FRIEDMAN, *supra* note 124.

126. *Id.* at 333.

127. *Id.* at 331–33.

128. Randall, *supra* note 124, at 630.

129. *Id.*

130. Paul v. Virginia, 75 U.S. 169 (1868).

131. *Id.* at 183.

earlier decision in *Paul v. Virginia*.[132] This time the U.S. Supreme Court held that insurance did constitute interstate commerce and was subject to federal regulation under the Commerce Clause.[133]

In spite of the decision in *South-Eastern Underwriters*, insurance was the only area of the financial services industry that did not come under at least partial federal regulation as an element of the New Deal.[134] This was due largely to the efforts of the NAIC. The NAIC, a voluntary body comprised of the insurance commissioners from all of the states, the District of Columbia, and the U.S. territories, viewed the decision in *South-Eastern Underwriters* as an assault on the states' power to regulate insurance and proposed a bill to reserve this power to the states.[135] The bill was enacted in 1945 as the McCarran-Ferguson Act,[136] and stated that federal law would not regulate insurance activities, provided those activities were (1) related to the "business of insurance," (2) regulated by state law, and (3) not designed to intimidate, coerce, or boycott.[137] The NAIC drafted model laws governing insurance with the All-Industry Committee, a group of insurance industry representatives organized by the NAIC, and worked to ensure that most of the states had adopted these laws by the early 1950s.[138]

In the 1960s, the insolvencies of several property-liability insurers sparked an interest to regulate insurance at the federal level.[139] Senator Edward Brooke, a Republican from Massachusetts, proposed the Federal Insurance Act, which would have allowed insurers to seek either a federal or a state charter.[140] Congress did not enact this proposal. Instead, in 1969, the NAIC proposed model legislation for state guaranty funds.[141] By 1982, all fifty states, the District of Columbia, and Puerto Rico had adopted some form of state guaranty fund legislation, although not all of

132. *See* United States v. S.-E. Underwriters Ass'n, 322 U.S. 533, 552–53 (1944).

133. *Id.*

134. SHEILA BAIR, UNIV. OF MASS. ISENBERG SCH. OF MGMT., CONSUMER RAMIFICATIONS OF AN OPTIONAL FEDERAL CHARTER FOR LIFE INSURERS 6–9 (2004), *available at* http://www.isenberg.umass.edu/finopmgt/uploads/textWidget/2494.00004/documents/bair-cons-ramifications.pdf [hereinafter BAIR, MASSACHUSETTS STUDY]; Randall, *supra* note 124, at 633–34.

135. Randall, *supra* note 124, at 629, 633.

136. Ch. 20, § 1, 59 Stat. 33 (1945) (current version at 15 U.S.C. §1011 (2004)).

137. Randall, *supra* note 124, at 633–34.

138. *Id.* at 634.

139. BAIR, MASSACHUSETTS STUDY, *supra* note 134, at 7.

140. *Id.* at 7. *See also* Federal Insurance Act, S. 1710, 95th Cong. (1977).

141. BAIR, MASSACHUSETTS STUDY, *supra* note 134, at 7; III—Insolvencies/Guaranty Funds, http://www.iii.org/media/hottopics/insurance/insolvencies/ (last visited Mar. 27, 2009).

these laws followed the NAIC model act.[142] The Federal Insurance Act bill was not the last time that the insurance sector faced the threat of federal regulation of insurance.

The federal government began regulating employer-sponsored retirement plans, and medical, life, and disability insurance following the enactment of the Employee Retirement Income Security Act ("ERISA") in 1974.[143] ERISA's requirements supersede any other applicable state insurance requirements. ERISA is administered through the Pension Benefit Guaranty Corporation, a federal agency that provides insurance to guarantee future pension payments.[144]

In the 1980s and early 1990s, several insurance company bankruptcies prompted renewed interest in federal regulation of insurance.[145] In 1990, a report by the House Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce found that the existing state regulations regarding insurance company solvency were inadequate.[146] Representative John Dingell, a Democrat from Michigan, proposed creating a dual system for insurance company solvency regulation, including the creation of a federal guaranty fund for federally chartered insurance companies.[147] This proposal also failed to be enacted after the NAIC and

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142. III—Insolvencies/Guaranty Funds, *supra* note 141. For example, New York's law uses a pre-assessment or pre-insolvency method for raising the necessary financing to pay off claims rather than the post-assessment or post-insolvency method proposed in the NAIC model act. *Id.* Under the New York law, the guaranty fund requires each insurance company to pay an amount into the fund based on a percentage of the net direct premiums written by the company during the year, and these funds are held to pay off future claims that may arise if an insurance company becomes insolvent. Under the NAIC model act, the state guaranty fund does not make any assessments until an insurance company becomes insolvent and then only assesses the amount needed from the other insurance companies to pay the claims of the insolvent company's policyholders. In addition, the NAIC model act does not create a state guaranty fund for annuities, life, disability, accident and health, surety, ocean marine, mortgage guaranty, and title insurance, but some state guaranty funds do cover claims against companies that write these types of insurance. *See id.*

143. BAIR, MASSACHUSETTS STUDY, *supra* note 134, at 7.

144. KENNETH J. MEIER, THE POLITICAL ECONOMY OF REGULATION: THE CASE OF INSURANCE 39 (1988).

145. *See* Jonathan R. Macey & Geoffrey P. Miller, *The McCarran-Ferguson Act of 1945: Reconceiving the Federal Role in Insurance Regulation*, 68 N.Y.U. L. REV. 13, 15 (1993).

146. BAIR, MASSACHUSETTS STUDY, *supra* note 134, at 8. *See also* STAFF OF H. COMM. ON ENERGY & COMMERCE, SUBCOMM. ON OVERSIGHT & INVESTIGATIONS, 101ST CONG., FAILED PROMISES: INSURANCE COMPANY INSOLVENCIES (Comm. Print 1990). The report is also known as the "Dingell Report," after Representative John Dingell, a Democrat from Michigan. BAIR, MASSACHUSETTS STUDY, *supra* note 134, at 8

147. BAIR, MASSACHUSETTS STUDY, *supra* note 134, at 8.

the many states adopted "risk-based capital requirements [for insurers similar to the banking requirements], a financial regulation accreditation program, and an initiative to codify statutory accounting principles."[148]

As a result of the decline in profitability of commercial banking, commercial banks sought to expand their products and services into more profitable financial services.[149] Beginning in 1983 with South Dakota, many states liberalized the rules governing state banks, permitting them to carry on insurance activities.[150] In 1991, Congress adopted the Federal Deposit Insurance Corporation Improvement Act,[151] which prohibited banks from engaging in insurance underwriting even if permitted under state law.[152] The Office of the Comptroller of the Currency ("OCC") in the U.S. Treasury Department through an interpretative release allowed national banks to sell annuities and to act as insurance agents if located in a town with less than 5000 residents.[153]

In 1999, Congress enacted the Gramm-Leach-Bliley Act ("GLBA"),[154] which repealed portions of the Glass-Steagall Act of 1933,[155] the Bank Holding Company Act of 1956,[156] and other laws in order to permit banks, securities firms, insurance companies, and other entities engaged in the provision of financial services to form financial conglomerates[157]

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148. *Id.*

149. *Id.*

150. Martin E. Lybecker, *The "South Dakota" Experience and the Bush Task Group's Report: Reconciling Perceived Overlaps in the Dual Regulation of Banking*, 53 BROOK. L. REV. 71, 72 (1987).

151. Pub. L. No. 102-242, § 303, 105 Stat. 2236, 2350 (codified in 12 U.S.C.S. § 1831a).

152. *Id*. § 303(a).

153. Interpretive Letter No. 753, Office of the Comptroller of the Currency, Letter Approving First Union National Banks Notification of Intent to Establish Operating Subsidiaries to Engage in Insurance Activities (Nov. 4, 1976), *available at* http://www.occ.treas.gov/interp/nov/int753.htm. *See also* 12 C.F.R. § 7.1001 (2009).

154. Pub. L. No. 106-102, § 1, 113 Stat. 1338 (1999) (codified in scattered sections of 12, 15, 16, 18 U.S.C.).

155. Ch. 89, 48 Stat. 162 (1933). The Glass-Steagall Act is the name given to four sections of the Banking Act of 1933, 12 U.S.C. § 377 (1933). The GLBA repealed section 20 of Glass-Steagall, which prevented any Federal Reserve member bank from affiliating with an entity principally engaged in securities, and section 33, which banned interlocking managements between Federal Reserve member banks and securities firms. Gramm-Leach-Bliley Act § 101, 12 U.S.C. §§ 377–78 (1999).

156. Ch. 240, 70 Stat. 133 (1956) (codified in 12 U.S.C. §§ 1841–49).

157. The Basel Committee on Banking Supervision and the Joint Forum on Financial Conglomerates define financial conglomerates as "any group of companies under common control whose exclusive or predominant activities consist of providing significant services in at least two different financial sectors." TRIPARTITE GROUP OF BANK, SEC. & INS. REGULATORS, THE SUPERVISION OF FINANCIAL CONGLOMERATES ¶ 36 (July 1995),

that would enable them to cross-sell each other's products and services. With the GLBA, Congress essentially ratified the movement away from institutional regulation towards functional regulation and the dismantling of the barriers among banks, securities firms, and insurance companies that rulemaking by the existing state and federal financial service regulatory agencies had already begun to undertake.[158]

Functional regulation focuses on the products or services being offered, rather than the institution offering them, to determine which regulator ought to regulate the products or services.[159] For example, under the GLBA, Congress envisioned the SEC regulating investments in securities regardless of whether the investment services were offered through a bank or through an independent brokerage firm. Within the institutional regulatory regime, banking regulators traditionally regulated securities offered through banks.[160]

This movement away from institutional regulation under the GLBA, however, did not occur in the area of insurance. Congress left insurance regulation primarily in the hands of the state insurance commissions. Section 104 of the GLBA reaffirmed that the states would retain control over the regulation of insurance products and services.[161] The GLBA did put a few limitations on the otherwise unfettered ability of the states to regulate insurance. For example, GLBA Section 104(c) prohibits states from preventing or restricting a depository institution or an affiliate of such institution from being affiliated with any person except in certain limited circumstances related to insurers.[162] The GLBA still permits

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available at http://www.bis.org/publ/bcbs20.pdf?noframes=1. This Article will use this definition when referring to financial conglomerates. Financial conglomerates are distinguishable from "mixed conglomerates," in which groups of commercial or industrial enterprises include a financial institution as part of their structure. *Id.* While mixed conglomerates may raise some of the same regulatory and supervisory issues as financial conglomerates, such concerns are beyond the scope of this Article.

158. *See* Brown, *supra* note 123, at 10–25.

159. *Id.* at 11.

160. Originally, sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934 excluded banks from the definitions of broker and dealer and left the regulation of banks engaging in securities activities to the banking regulators. Securities Exchange Act of 1934 §§ 3(a)(4)–(5), 15 U.S.C. §§ 78c(a)(4)–(5) (1998). The GLBA amended those sections to eliminate the exception for banks. Gramm-Leach-Bliley Act §§ 201–02. If a bank's securities activities do not fall into one of the other categories of permissible bank securities activities set forth in the GLBA, then the bank is required to transfer those broker-dealer activities to an affiliated broker-dealer.

161. Gramm-Leach-Bliley Act § 104.

162. *Id.* § 104(c). Prior to the GLBA's enactment, nine states and one territory prohibited banks from affiliating with insurance companies. CONFERENCE OF STATE BANK SUPERVISORS, A PROFILE OF STATE CHARTERED BANKING 117–19 (17th ed. 1998). Those

states to collect, review, and take actions (including approval or disapproval) on applications that concern the proposed acquisition, change in control, or continued control of an insurer domiciled in the state; that require a person seeking to acquire control of an insurer to maintain or restore the insurer's capital requirements under the state's capital regulations, or that restrict the change in control in the ownership of stock of the insurer, or a company formed for the purpose of controlling the insurer, after the insurer has converted from a mutual to a stock form, so long as such restrictions do not discriminate against depository institutions or their affiliates.[163]

The GLBA also required states to establish uniform or reciprocal requirements for licensing of insurance agents within three years after the enactment of the act.[164] The GLBA mandated that the NAIC had to determine whether a majority of states had to meet this requirement.[165] If NAIC was unable to do so, then the National Association of Registered Agents and Brokers ("NARAB") would be established as a nonprofit corporation to act as a mechanism through which "uniform licensing, appointment, continuing education, and other insurance producer sales qualification requirements and conditions" could be adopted.[166]

Perhaps not surprisingly, when given a choice between reciprocity and uniformity, the states chose reciprocity.[167] Reciprocity only requires that states accept the licensing decisions of other states, even though their requirements might be different, while uniformity would have required states to apply the same set of licensing requirements. Currently, the

states and territory were Alaska, Arkansas, Colorado, Georgia, New York, Puerto Rico, Tennessee, Vermont, and West Virginia. *Id.*

163. Gramm-Leach-Bliley Act § 104(c)(2). The GLBA also preserves the rights of states to restrict certain insurance activities by depository institutions or insurers licensed in the state regardless of where they are domiciled. *Id.* § 104(d). In the event of a dispute between federal and state insurance regulators, the GLBA provides a dispute resolution mechanism under which either regulator is permitted to seek expedited review from the U.S. Court of Appeals for the District of Columbia or the state's proper U.S. Circuit Court of Appeals. *Id.* § 304. *See also* 15 U.S.C. 6714 (2004).

164. Gramm-Leach-Bliley Act § 321. *See also* 15 U.S.C. 6751.

165. Gramm-Leach-Bliley Act § 304. *See also* 15 U.S.C. 6714.

166. Gramm-Leach-Bliley Act §§ 322–23. *See also* 15 U.S.C. 6752–53.

167. *Testimony Before the Subcomm. on Capital Markets, Insurance and Government Sponsored Enterprises, Comm. on Financial Serv., H. of Rep., State Insurance Regulation: Efforts to Streamline Key Licensing and Approval Processes Face Challenges*, at 2 (June 18, 2002) (statement of Richard J. Hillman, Director, Financial Markets and Community Investment, General Accounting Office) [hereinafter *Hillman Testimony*].

NAIC has certified forty-three states as meeting the reciprocity requirements under the GLBA.[168]

Nevertheless, major states, like California, Florida, and New York, still have not complied with the reciprocity requirements.[169] The major stumbling blocks against reciprocity among all fifty states concern fingerprinting and surplus lines bond requirements for nonresident producers, which are considered important consumer protection issues in the states that require them, particularly California and Florida.[170]

Finally, the GLBA permits banks, securities firms, insurance companies, and other entities engaged in financial services to become affiliated under the umbrella of a financial holding company ("FHC") and allowed these firms to cross-sell each other's products.[171] The GLBA designated the Federal Reserve, which supervises bank holding companies, to become the supervisor for the FHCs, although the financial subsidiaries of the FHCs would continue to be regulated by the relevant authority for their product or service.[172] The Act also specifies that FHCs and their subsidiaries may engage in certain activities that are financial in nature, including securities underwriting and dealing, insurance underwriting, insurance agency activities, and merchant banking.[173] An FHC also may engage in any activity that the Federal Reserve, in consultation with the Secretary of the Treasury, determines to be financial in nature, incidental to finance, or complementary to a financial activity, provided that such activity does not pose a substantial risk to the safety and soundness of the FHC.[174]

The number of domestic FHCs declined from 612 in 2003, to 597 in 2007.[175] The vast majority of the companies registered as FHCs were

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168. NAT'L ASS'N OF INS. COMM'RS, PRODUCER LICENSING ASSESSMENT AGGREGATE REPORT OF FINDINGS 2 (2008), *available at* http://www.naic.org/Releases/2008_docs/producer_licensing_assessment_report.pdf [hereinafter NAIC, RECIPROCITY REPORT].

169. *See id.* n.1.

170. *See id.* exhibit A, at 3–4 (finding that background checks and surplus lines bonds are "inconsistent with the reciprocity requirements under GLBA").

171. Gramm-Leach-Bliley Act § 103(a).

172. *Id.* § 113 For example, an insurance company owned by an FHC would still be subject to state insurance regulators.

173. *Id.* § 103. For certain financial activities, FHCs may be subject to joint regulation by the Federal Reserve and another regulatory authority. *See id.* §§ 112–13.

174. *Id.* § 103.

175. INS. INFO. INST. & FIN. SERVS. ROUNDTABLE, THE FINANCIAL SERVICES FACT BOOK 2009, at 45 (2009).

bank holding companies before the enactment of the GLBA.[176] Only a few insurance firms that were not previously affiliated with a commercial bank before the enactment of GLBA elected to become FHCs.[177] MetLife falls into this category.[178] Many of the largest financial conglomerates with substantial insurance businesses have not registered as FHCs, including AIG, because insurance firms were not subject to the limitations on affiliations that banking firms were subject to before the adoption of the GLBA.[179]

Just because insurance companies are not registering as FHCs does not mean that they are engaging in a limited range of financial services. For example, before the current financial crisis began, thirty-four insurance companies, including AIG, entered into banking-related activities by acquiring thrifts.[180] In the wake of the enactment of the Emergency Economic Stabilization Act of 2008, several other insurance companies acquired thrifts in order to become eligible under the Act to receive funds as thrift holding companies from the Capital Purchase Program and the Temporary Liquidity Guarantee Program of the Federal Deposit Insurance Corporation.[181] The Office of Thrift Supervision ("OTS") in the

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176. BD. OF GOVERNORS OF THE FED. RESERVE SYS. & U.S. DEP'T OF THE TREASURY, REPORT TO THE CONGRESS ON FINANCIAL HOLDING COMPANIES UNDER THE GRAMM-LEACH-BLILEY ACT 3 (2003).

177. *Id.*

178. *Id.*

179. *See* FRB: Financial Holding Companies as of March 27, 2009, www.federalreserve.gov/generalinfo/fhc/ (last visited Apr. 6, 2009). In fact, only one of the top five companies classified as diversified financials by *Fortune* in 2007 has registered as FHCs. *Id.* Steve Bartlett, the President and Chief Executive Officer of the Financial Services Roundtable, commented in his testimony before the Senate Committee on Banking, Housing and Urban Affairs on July 13, 2004:

> One of the central features of GLBA was the creation of financial holding companies. . . . The financial holding company structure significantly expanded the scope of activities permissible for banking firms; it did not offer insurance firms and securities firms a similar benefit. Outside of the financial holding company structure, securities and insurance firms are subject to few limitations on affiliations. Thus, it is not surprising that only a handful of securities and insurance firms have become financial holding companies.

Testimony to the Comm. on Banking, Housing and Urban Affairs of the U.S. S., at 8 (July 13, 2004) (statement of Steve Bartlett, President and Chief Executive Officer, Financial Services Roundtable).

180. INS. INFO. INST. & FIN. SERVS. ROUNDTABLE, THE FINANCIAL SERVICES FACT BOOK 2006, at 58–59 (2006) (listing thirty-four insurance companies that acquired thrifts).

181. News Bulletin, Morrison & Foerster, Insurance Companies Adopt Thrift Holding Company Structure to Become Eligible for Treasury Capital Purchase Program and FDIC

U.S. Treasury Department, not the Federal Reserve, acts as the primary regulator for thrift holding companies that own a federally chartered thrift.[182] The near bankruptcy of AIG has raised questions about whether the OTS is equipped to regulate complex financial conglomerates.[183]

The fact that financial conglomerates can gain access to bailout funds by either becoming a bank holding company or a thrift holding company undermines the intent of the GLBA that financial conglomerates should become FHCs and be regulated by the Federal Reserve. Congress may need to reconsider who regulates financial conglomerates at the federal level and how regulations can be harmonized to prevent firms like AIG from engaging in regulatory arbitrage to find the weakest regulator.

B. State Efforts at Uniformity

Attempts by Congress, the NAIC, and elements within the insurance industry to encourage uniform state insurance regulations have not proven particularly successful. The states cannot agree on the most basic issues, such as a uniform definition for insurance. Several states do not even try to define insurance in their statutes.[184] In these states, one must look to state common law for a definition.[185]

In states that do define insurance or a contract of insurance in their statutes, many of the definitions are short and cryptic. The California Insurance Code, for example, defines insurance as "a contract whereby one undertakes to indemnify another against loss, damage, or liability arising from a contingent or unknown event."[186] This definition is extremely broad and could encompass a variety of other financial services products. Guaranties, warranties, suretyships, indorsements, pledges, mortgages, conditional sales, indemnity, and insurance all have the common purpose of protecting someone from the harms of possible future events.[187] Not all of these products, however, are regulated by state insurance commissioners. Other states employ longer, but not necessarily more useful, definitions in their statutes. New York defines an insurance contract as

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Liquidity Guarantee (Nov. 23, 2008), *available at* http://www.mofo.com/news/updates/files/081123Insurance.pdf.

182. Office of Thrift Supervision—About the ORT, http://www.ots.treas.gov/?p=About OTS (last visited Apr. 18, 2009).

183. Jeff Gerth, *Was AIG Watchdog not up to the Job?*, PROPUBLICA, Nov. 10, 2008, http://www.propublica.org/feature/was-aig-watchdog-not-up-to-the-job.

184. ERIC M. HOLMES & JOHN ALAN APPLEMAN, INSURANCE LAW AND PRACTICE, 2d § 1.3 (2008).

185. *Id.*

186. CAL. INS. CODE § 22 (Deering 2008).

187. HOLMES & APPLEMAN, *supra* note 184.

> any agreement or other transaction whereby one party, the "insurer", is obligated to confer benefit of pecuniary value upon another party, the "insured" or "beneficiary", dependent upon the happening of a fortuitous event in which the insured or beneficiary has, or is expected to have at the time of such happening, a material interest which will be adversely affected by the happening of such event.[188]

New York further defines a fortuitous event as "any occurrence or failure to occur which is, or is assumed by the parties to be, to a substantial extent beyond the control of either party."[189]

Given these differences in how insurance is defined, states sometimes disagree over whether a particular product should be regulated as insurance, securities, or banking products. State insurance supervisors have contemplated regulating certain derivatives as insurance even though these products are frequently treated as falling within the regulatory scope of securities or futures regulators.[190] Derivatives cover a wide range of products. These products essentially involve an agreement, option, or instrument that requires the buyer to take delivery or assume a specified amount of one or more underlying interests, or that has a price, performance, value, or cash flow based primarily upon the actual or expected price, level, performance, value, or cash flow of one or more underlying interests.[191] Derivatives include options, futures, swaps, warrants, hedges, and securitizations.[192] The sellers use these transactions to reduce their risks due to changes in price, performance, value, or cash flow of the underlying interests.

Derivatives are often used as substitutes for insurance regardless of whether they are regulated as insurance.[193] Credit default swaps, weather

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188. NY INS. LAW § 1101(a)(1) (Consol. 2008).

189. *Id.* § 1101(a)(2).

190. *See, e.g.*, JAN JOB DE VRIES ROBBÉ & PAUL U. ALI, SECURITISATION OF DERIVATIVES AND ALTERNATIVE ASSET CLASSES: YEARBOOK 2005, at 82 (2005) (discussing the draft NAIC White Paper recommending that weather derivatives be regulated as insurance even though the International Swaps and Derivatives Association, the Weather Risk Management Association, and the Bond Markets Association preferred that they be treated as securities or futures).

191. KEITH REDHEAD, FINANCIAL DERIVATIVES: AN INTRODUCTION TO FUTURES, FORWARDS, OPTIONS AND SWAPS 1–3 (1997).

192. *Id.* at 1.

193. For a fuller discussion of some of these instruments, see Tamar Frankel & Joseph W. LaPlume, *Securitizing Insurance Risks*, 19 ANN. REV. BANKING L. 203 (2000); Peter Carayannopoulos, Paul Kovacs & Darrell Leadbetter, *Insurance Securitization: Catastrophic Event Exposure and the Role of Insurance Linked Securities in Addressing Risk* (ICLR Research Paper Series No. 27, 2003), *available at* http://www.iclr.org/pdf/securi tization.pdf; J. David Cummins, *CAT Bonds and Other Risk-Linked Securities: State of the Market and Recent Developments* (Temple Univ., 2007), *available at* http://ssrn.com/

derivatives, real estate hedges, and insurance securitization in the form of asset-backed bonds all function like insurance.[194] The market for credit default swaps has exploded in the past decade, reaching almost $62 trillion in 2008.[195] Credit default swaps have avoided regulation because they have been deemed to fall in the gaps among the insurance, securities, and futures regulatory authorities. For example, New York State has flip-flopped in the past year regarding whether to regulate credit default swaps as insurance. For years, New York State chose not to regulate credit default swaps as insurance. On September 22, 2008, the New York Insurance Department changed its mind and decided that, beginning in January 2009, credit default swaps "in cases where the buyer of the swap also owns the underlying bond it is meant to back" would be classified as insurance in New York.[196] Less than two months later, New York suspended its plan to regulate credit default swaps in light of the initiatives to regulate over-the-counter derivatives, including credit default swaps, announced by the President's Working Group on Financial Markets and the MOU signed by the Federal Reserve Board of Governors, the SEC, and the Commodities Futures Trading Commission to supervise credit default swap counterparties.[197]

If a product meets a state's definition of insurance, then both the product and the firm offering it must be licensed by the state in order to sell

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abstract=1057401; Richard W. Gorvatt, *Insurance Securitization: The Development of a New Asset Class* 133 (Cas. Actuarial Soc'y, "Securitization of Risk" Discussion Paper Program, 1999), *available at* www.casact.org/pubs/dpp/dpp99/99dpp133.pdf; Changki Kim, Taehan Bae & Reginald J. Kulperger, *Securitization of Motor Insurance Loss Rate Risks* (Australian Sch. of Bus., Research Paper No. 2008ACTL03, 2008), *available at* http://ssrn.com/abstract=1134606.

194. *E.g.*, INS. INFO. INST. & FIN. SERVS. ROUNDTABLE, THE FINANCIAL SERVICES FACT BOOK 2006, at 133 (discussing credit derivatives); *id.* at 84 (discussing weather derivatives). *See also* Frankel & LaPlume, *supra* note 193, at 205–06; Carayannopoulos, Kovacs & Leadbetter, *supra* note 193; Gorvatt, *supra* note 193, at 144–48; Kim, Bae & Kulperger, *supra* note 193, at 2–3; Simone Barbibeau, *Four Ways to Hedge Against Falling Home Prices*, THESTREET.COM, Feb. 22, 2008, www.thestreet.com/print/story/10404177.html. Insurance securitization can take a number of forms other than the issuance of asset-backed bonds. It can also involve forwards, futures, options, puts, and swaps. Some of these instruments are used to transfer risk, such as bonds and swaps, while others are used to provide contingent capital, such as catastrophic equity puts.

195. Danny Hakim, *New York to Regulate Credit Default Swaps*, N.Y. TIMES, Sept. 22, 2008, at C10.

196. *Id*.

197. Press Release, Eric Dinello, Superintendent of Ins., N.Y. State Ins. Dep't, Recognizing Progress by Federal Government in Developing Oversight Framework for Credit Default Swaps, New York Will Stay Plan to Regulate Some Credit Default Swaps (Nov. 20, 2008), *available at* http://www.ins.state.ny.us/press/2008/p0811201.htm.

the product within that state.[198] So if New York had not suspended its decision to classify some credit default swaps as insurance, firms selling them in New York would have needed to be licensed as insurers. The states within the United States have a confusing series of licensing and post-licensing requirements for both the firm offering the product and the product itself. The exact type of licenses required varies from state to state. Some states issue a general insurance producer license, which allows an individual or an entity to sell several insurance services, while others issue separate licenses for agents and brokers or issue separate licenses for each insurance line.[199]

Traditionally, states have operated their insurance commissions as regulatory monopolies and have not engaged in regulatory competition, which exists to some degree between state and federal government agencies that issue bank charters, and among states for the incorporation of businesses.[200] Other than the periodic threats by the federal government that it will begin regulating insurance if the states fail to adopt reciprocal or uniform licensing requirements, the states have had few incentives to change their licensing procedures. If a company wants to offer insurance in a particular state, the company must comply with the licensing and post-licensing regulations for that state.[201]

In addition to requiring different types of licenses, states have a range of requirements when potential insurance producers complete their applications. In some cases, these variations among the states' applications are due to important differences on policy questions. New York and California require criminal background checks before allowing a person to sell insurance within their borders, but many other states do not require such

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198. BAIR, MASSACHUSETTS STUDY, *supra* note 134, at 11.

199. NAT'L ASS'N OF INS. COMM'RS, 2002 INSURANCE DEPARTMENT RESOURCES REPORT 52 (2003). The NAIC defines "producer" as a person or entity "[l]icensed to offer several insurance services." *Id*. In most cases, a producer will be a company, rather than an individual.

200. Henry Butler and Larry Ribstein have proposed recreating the type of regulatory competition among states for incorporating businesses in the area of insurance. *See* Henry N. Butler & Larry E. Ribstein, *The Single-License Solution*, REGULATION (Winter 2008–2009), at 36, 36. Their proposal, like the Congressional proposals to federalize insurance regulation, treats insurance as a unique financial service that requires a separate regulatory agency from the ones that regulate banking and securities. *See id.* It does not recognize that financial services are part of a continuum in which products and services in one sector, such as insurance, are increasingly fungible with products and services in another, such as securities. As a result, their proposal does not address the existing trends within the financial services industry, but would reinforce the current compartmentalization of financial services regulation along a blend of institutional and functional regulation.

201. *See Hillman Testimony*, *supra* note 167, at 7 (noting that even if licensing regulations are removed, there may still be post-licensing hurdles for insurance companies).

checks.[202] In other cases, these variations have little or no rational basis. In Nevada, for example, pink paper is required when insurance companies file documentation pages for filing fees.[203] Some states, such as Iowa, Kentucky, and Ohio, will return filings if they have not been stapled in the prescribed manner or assembled in the proper order.[204]

Forty-three states do grant some form of reciprocity if a company has been granted a license in another state.[205] States with major markets, like California, Florida, and New York, however, have not signed on to these reciprocity agreements.[206] These agreements also do not extend to post-licensing requirements.[207]

In 2004, the University of Massachusetts Isenberg School of Management completed a study ("Massachusetts Study"), which found that the multiple state reviews resulted in duplicative and inefficient regulatory efforts among the states.[208] States have attempted to justify these duplicative reviews as necessary to protect consumers, but the Massachusetts Study concluded that the extremely high caseloads for staff assigned to review producer licensing applications indicated that these applications may only be receiving a cursory review.[209] On average, staff members had to review 1284 new applications per year.[210] Such cursory reviews may fail to alert staff to producer problems, which is troubling "given . . . that producer misconduct generates the largest volume of complaints."[211]

The process might be a bit easier in the future for life insurance, annuities, disability income, and long-term care insurance because the Interstate Insurance Product Regulation Commission ("IIPRC") began cover-

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202. *Id.* at 2, 5–6.

203. Andrew G. Simpson, *Leave-No-State-Regulation-Behind*, INS. J., Sept. 6, 2004, http://www.insurancejournal.com/magazines/east/2004/09/06/editorsnote/45946.htm.

204. *Id*.

205. NAIC, RECIPROCITY REPORT, *supra* note 168, at 2 & n.1.

206. *See Hillman Testimony*, *supra* note 167, at 2, 5–6.

207. *See id*. at 7.

208. BAIR, MASACHUSSETS STUDY, *supra* note 134, at executive summary. The study was funded by unrestricted grants from MassMutual, Equitable Life, Lincoln National Life, Northwestern Mutual, Principal Financial Group, Prudential Life Insurance, and the American Council of Life Insurers. The study identified several major problems with the existing state system of insurance regulation. The study focused solely on life insurance and not the other forms of insurance, although it did concede that other insurers, particularly property and casualty insurers, faced many of the same regulatory inefficiencies. *Id*. & n.project team.

209. *Id*. at executive summary.

210. *Id*.

211. *Id*.

ing these products in 2007.[212] The IIPRC was formed under the Interstate Insurance Compact proposed by the NAIC.[213] The IIPRC provides a central filing point for institutions seeking licenses for insurance products from the states that are parties to the compact.[214] The IIPRC initially had to rely on product filing examiners and other staff, who are on loan from member states.[215] It did not get its own permanent staff until the spring of 2008.[216] Only thirty-two states, plus Puerto Rico, have signed the Interstate Insurance Compact and, once again, the states with the largest insurance markets, California, Connecticut, Florida, and New York, are not signatories to this agreement.[217] It may be some time before an assessment can be made as to whether the IIPRC has significantly improved the process for obtaining product licenses.

In addition to having to complete multiple producer licensing and product licensing applications, an insurance company will find that it may take up to two years under normal circumstances to have all of the state insurance regulators review and approve the company's applications.[218] While the NAIC has made the adoption of national, uniform regulations one of its goals, the states have not made significant progress towards developing such regulations.[219] Reciprocity arrangements, which a majority of states adopted in the wake of the GLBA, have shortened the time that it takes to complete the nonresident producer licensing process.[220] Nevertheless, according to the Massachusetts Study, insurers

212. News Release, Interstate Ins. Prod. Regulation Comm'n, Interstate Insurance Compact Open for Business (June 2, 2007), *available at* http://www.insurancecompact.org/releases/open_for_business.htm.

213. A Summary of the IIPRC Background and Development, http://www.insurancecompact.org/history.htm (last visited Mar. 30, 2009).

214. News Release, Interstate Ins. Prod. Regulation Comm'n, *supra* note 212.

215. *Id*.

216. IIPRC, About the IIPRC, http://www.insurancecompact.org/about.htm (last visited Mar. 30, 2009).

217. IIPRC, Commission Member States, http://www.insurancecompact.org/documents/about_member_states.pdf (last visited Mar. 30, 2009).

218. BAIR, MASSACHUSETTS STUDY, *supra* note 134, at 37 (noting that seventeen percent of companies surveyed reported that new company licenses took more than two years). *See also Insurance Product Approval: The Need for Modernization: Hearing Before the Subcomm. on Capital Markets, Insurance, and Government Sponsored Enterprises of the H. Comm. on Financial Servs.*, 107th Cong. 54–55 (2001) (opening statement by Richard H. Baker, Chairman) [hereinafter *Baker Statement*].

219. *See Baker Statement*, *supra* note 218 (noting that "insurers are subject to a patchwork quilt of State regulation").

220. BAIR, MASSACHUSETTS STUDY, *supra* note 134, at 29.

reported in 2003 that it took them six to nine months to get a product approved in the five largest states in which they did business.[221]

If it takes two years for traditional insurance products to be approved by all of the state regulators, innovative products may take even longer, particularly if they are hybrid financial products that have characteristics similar to traditional banking or securities products.[222] Hybrid products may require the approval of the federal or state banking or securities authorities, in addition to the approval of the state insurance commissioners.[223]

The problems caused by the licensing delays particularly disadvantage smaller insurance companies. These delays hinder the ability of smaller companies to expand operations.[224] Survey data indicate that, under the current system, regulatory costs are proportionately higher for small insurers.[225] Licensing delays discourage some forms of product and regulatory innovation. Some products are not brought to market because the costs of overcoming the initial regulatory approvals are high, and once they have been overcome, other firms may easily copy the product and sell it themselves.[226] In these instances, the first mover bears the bulk of the costs while later movers reap the rewards. In addition, as the Massachusetts Study noted, "Difficulties and time delays in securing form filing approvals inhibits the ability of life insurers to modify products in response to consumer demand and impairs competition with banks and securities firms that do not have to undergo advance merit review of permitted product offerings."[227]

Given that states cannot agree on uniform standards within the United States, it is doubtful that they would work well together when negotiating

221. *Id*. at 37–43, executive summary.

222. The program that offered the home equity insurance in Syracuse, New York, had to ensure that it complied both with New York's insurance regulations and New York's banking laws. *See* Andrew Caplin et al., *Home Equity Insurance: A Pilot Project* 2, 24–28 (Yale Int'l Ctr. for Fin., Working Paper No. 03-12, 2003), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=410141.

223. *Id*. at 26–27. For example, the program could not include the home equity insurance policy as part of the mortgage contract because that would have violated New York's banking restrictions against Price-Level Adjusted Mortgages.

224. BAIR, MASSACHUSETTS STUDY, *supra* note 134, at 11–12, 51, 68.

225. *Id*. at 11–12.

226. The first insurance company would have a period of time during which it would be the sole provider of a new product because state regulators keep rate filings and product filings confidential until they are approved. While competitors would sustain lower legal and administrative costs to get a product approved than the first firm, they would still have to bear the costs of determining how to underwrite it, reserve for it, market it, and administer it.

227. BAIR, MASSACHUSETTS STUDY, *supra* note 134, at executive summary.

international standards in the form of either soft law standards or principles, or hard law found in treaties and other binding international agreements. David Snyder, Assistant General Counsel of the American Insurance Association, noted, "Despite the strong efforts of some regulators, the state regulatory system is structurally incapable of representing U.S. interests effectively, because it must defend the inefficient U.S. regulatory system and it lacks the legal authority to bind the United States."[228] The states have recently attempted to increase their visibility in the IAIS. While the states within the United States only held one of the seats on the old IAIS executive committee, they now hold three of the twenty-one seats on the newly enlarged IAIS executive committee.[229] In addition, a fourth U.S. regulator, who chairs a technical subgroup, sits as a nonvoting member on the committee.[230] Sandy Praeger, the Kansas Insurance Commissioner, is leading the IAIS's New Focus Task Force, which will be developing future goals of the IAIS.[231]

C. Possible Solutions

1. Office of Insurance Information and New Powers for USTR

In March 2008, the U.S. Treasury issued its Blueprint for a Modernized Financial Regulatory Structure ("Blueprint").[232] Each of the regulatory structures the Treasury proposed would correct the existing inability of the United States to engage in meaningful international negotiations on insurance issues. The Blueprint calls for the creation of an Office of Insurance Oversight "to deal with international [insurance] regulatory issues . . . [and to] advise the Secretary of the Treasury on major domestic and international [insurance] policy issues."[233]

In response to the Treasury's proposal, Representative Paul Kanjorski introduced the Insurance Information Act of 2008,[234] which would create the Office of Insurance Information. This office would provide information on insurance issues to Congress and to Executive Branch agencies.

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228. Meg Fletcher, *U.S. Regulators Seek to Increase Visibility*, INS. NEWS NET, Jan. 5, 2009, at 3.

229. *Id.*

230. *Id.*

231. *Id.*

232. U.S. DEP'T OF TREASURY, BLUEPRINT FOR A MODERNIZED FINANCIAL REGULATORY STRUCTURE (2008), *available at* http://www.treas.gov/press/releases/reports/Blueprint.pdf [hereinafter U.S. TREASURY BLUEPRINT].

233. *Id.* at 132–33.

234. Insurance Information Act of 2008, H.R. 5840, 110th Cong. (2d Sess. 2008). This act was introduced by Representative Paul Kanjorski (a Democrat from Pennsylvania).

In addition, the Insurance Information Act would give the federal government the power to negotiate treaties and international agreements setting insurance regulatory standards and practices that would preempt state insurance laws.[235]

The Insurance Information Act could effectively serve as a back-door means for implementing the same type of uniform rules that the proposed State Modernization and Regulatory Transparency Act ("SMART Act")[236] would have created. Former Representative Michael Oxley (a Republican from Ohio) and Representative Richard Baker (a Republican from Louisiana) conceived the SMART Act as a means of getting the states to overcome the lack of uniform regulations and the high costs of the state regulation of insurance.[237] Representative Oxley tried to model the SMART Act after those provisions in the GLBA that threatened to create a federal regulator if the states failed to enact certain types of laws and regulations within a fixed timeframe.[238] Those provisions in the GLBA spurred the states to enter into reciprocity agreements that reduced the number of state licensing applications insurers had to file.

The SMART Act, if it had been enacted, would have required the states to adopt the NAIC model laws regarding market conduct within three years, or required that these model acts become law automatically at the end of the three-year period and preempt any contradictory laws.[239] It also would have required states to adopt the NAIC model laws governing licensing of insurers, producers, and reinsurers within two to three years or their laws would be preempted by the NAIC laws.[240] In addition, the SMART Act would have required the states to end their regulation of rates after two years.[241]

The SMART Act, however, was never even introduced into Congress as a bill. The insurance industry's response to it was mixed and the states opposed it. What really doomed its introduction was its questionable constitutionality. The U.S. Supreme Court in *New York v. United States* stated that Congress cannot compel the states to enact or enforce a feder-

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235. *Id*. § 313(e).

236. State Modernization and Regulatory Transparency Act, Staff Discussion Draft (2004), *available at* http://www.alta.org/advocacy/news.cfm?newsID=2689 (follow "Title" hyperlinks to access individual sections) [hereinafter SMART Draft].

237. *Rep. Oxley Outlines Road Map to State-Based Insurance Regulatory Reform*, STATES NEWS SERVICE, Mar. 15, 2004.

238. *See id.* Nonetheless, Representative Oxley specifically stated that while the success of such a program hinged on federal-state cooperation, Congress "will not create a Federal regulator." *Id.*

239. SMART Draft, *supra* note 236, § 204.

240. *Id*. §§ 301, 403, 900.

241. *Id*. § 1601(e).

al regulatory program.[242] In addition, the Court in *Printz v. United States* asserted that the federal government cannot require state officers to address particular problems.[243] Both of these cases raised the specter that the states would have been able to launch a successful lawsuit to have the SMART Act struck down as invalid if Congress had ever enacted it.

The Insurance Information Act would not suffer from these problems. In *Missouri v. Holland*, the Supreme Court held that Congress can impose national norms on the states through its treaty power.[244] *Missouri* concerned the Migratory Bird Act of 1918, which implemented a convention between the United States and Great Britain, while the latter still controlled Canada; this Act protected migratory birds that were on the verge of extinction from excessive hunting.[245] Congress had previously tried to protect wildlife in various acts only to have the Supreme Court strike them down as exceeding Congress's constitutional authority under the Commerce Clause.[246] Senator Elihu Root proposed that Congress sidestep this problem by negotiating an international agreement with Great Britain covering migratory birds and then having Congress pass a statute to implement the agreement under its treaty powers.[247] The Insurance Information Act would allow Congress to follow the *Missouri* example by enacting legislation similar to the SMART Act as long as Congress could justify it as necessary to implement an international agreement.

While the NAIC has endorsed the Insurance Information Act, some state legislators are opposed to it because they fear it will strip them of their ability to set insurance standards and regulations.[248] They fear that standards negotiated by the federal government will be weaker than those currently administered by the states, thus harming consumers.

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242. New York v. United States, 505 U.S. 144, 149 (1992).

243. Printz v. United States, 521 U.S. 898, 944–45 (1997).

244. Missouri v. Holland, 252 U.S. 416, 432 (1920).

245. *Id.* at 431–32.

246. Likewise, state laws that appear to intrude on Congress's power under the Commerce Clause have been upheld as valid exercises of state authority. *See, e.g.*, Greer v. Connecticut, 161 U.S. 519, 522, 528–29 (1896) (holding that wild game within the territory of a state was held by the state in trust for its citizens).

247. David M. Golove, *Treaty-Making and the Nation: The Historical Foundations of the Nationalist Conception of the Treaty Power*, 98 MICH. L. REV. 1075, 1255 & n.604 (2000) (citing Senator Robinson's quote of Senator Root's comments (51 CONG. REC. 8349 (1914)).

248. *See* Sara Hansard, *NAIC May Support Federal Office of Insurance Information*, INVESTMENTNEWS, June 23, 2008, http://www.investmentnews.com/apps/pbcs.dll/article?AID=/20080623/REG/733305324/1009/TOC.

The Subcommittee forwarded the Insurance Information Act to the full Financial Services Committee on July 9, 2008, but Congress did not pass the bill before the end of its term.[249] Several congressional supporters sent a letter on January 23, 2009, to Timothy Geithner urging him to create the Office of Insurance Information once he was confirmed as Treasury Secretary.[250] Other groups have publicly opposed having the Office of Insurance Information created by fiat and demanded that it only be created through an act of Congress.[251] If Treasury Secretary Geithner does not unilaterally create the Office of Insurance Information, then the Insurance Information Act will be reintroduced in the 111th Congress and stands a reasonable chance of enactment.

2. Office of National Insurance

If Congress does not enact the Insurance Information Act, it could still improve the United States' ability to negotiate international agreements if it created an Office of National Insurance ("ONI") and set up an optional federal charter system for insurance. The U.S. Treasury Blueprint recommended such a scheme as an intermediate step in reforming the U.S. regulatory structure for financial services. This optional federal charter system would operate in a manner similar to the dual-chartering system currently used for banks.[252] The proposal called for the creation of ONI within the Treasury and for it to be headed by a single National Insurance Commissioner.[253] The Blueprint included a disclaimer that the Treasury is not opining upon or evaluating the merits of any pending legislation before Congress to create an optional federal charter.[254] The Treasury did recommend that any legislation authorizing the creation of

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249. GovTrack.us, H.R. 5840 [110th]: Insurance Information Act of 2008, http://www.govtrack.us/congress/bill.xpd?bill=h110-5840 (last visited Apr. 18, 2009).

250. Sara Hansard, *House Members Push for Insurance Info Office*, INVESTMENTNEWS, Jan. 23, 2009, http://www.investmentnews.com/apps/pbcs.dll/article?AID=/20090123/REG/901239979/1029/INSURANCE. Representatives Melissa Bean, a Democrat from Illinois, Ed Royce, a Republican from California, Dennis Moore, a Democrat from Kansas, Michael Castle, a Republican from Delaware, Andrew Carson, a Democrat from Indiana, John Campbell, a Republican from California, and John Adler, a Democrat from New Jersey, signed the letter. *Id*.

251. Arthur D. Postal, *Federal Oversight Foes Oppose Move for Treasury to Create OII Unilaterally*, NAT'L UNDERWRITER, Feb. 2, 2009, http://www.propertyandcasualtyinsurancenews.com/cms/nupc/Weekly%20Issues/issues/2009/04/News/P04FEDS.

252. U.S. TREASURY BLUEPRINT, *supra* note 232, at 126.

253. *Id*. at 126, 131–32.

254. *Id*. at 128 n.110.

an optional federal chartering system should provide for "solvency regulation, market competition, and consumer protection."[255]

Nevertheless, the optional federal charter envisioned by the Blueprint looked similar to the one detailed in the proposed National Insurance Act of 2007 ("NIA"),[256] which Congress was already considering. The 110th Congress never enacted the NIA before the end of its term.[257] Two of the NIA's original sponsors, Representative Melissa Bean of Illinois and Representative Edward Royce of California, introduced a new optional federal insurance charter bill into Congress on April 2, 2009.[258] This bill, the National Insurance Consumer Protection Act ("NICPA"),[259] contains many of the same features as the NIA, but would also create a systemic regulator for financial institutions.

The NICPA provides insurers with the option of seeking a state charter or a federal charter to write life or property/casualty insurance policies. It would create a new federal insurance agency, the ONI, which is modeled after the OCC and is also located within the Treasury Department.[260] The ONI would be run by one commissioner appointed by the President for a five-year term.[261]

The ONI would regulate national insurers, national insurance agencies, federally licensed producers, and reinsurers.[262] Regulations promulgated

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255. *Id*. at 129–31.

256. The National Insurance Act was first introduced to Congress as the National Insurance Act of 2006, S. 2509, 109th Cong. (2d Sess. 2006). Senators John Sununu (a Republican from New Hampshire) and Tim Johnson (a Democrat from South Dakota) cosponsored this bill. A virtually identical companion bill was introduced to the House of Representatives by Representative Edward Royce (a Republican from California). NIA was reintroduced to Congress as the National Insurance Act of 2007, S. 40, 110th Cong. (1st Sess. 2007) [hereinafter NIA], and by Representatives Royce and Melissa Bean as H.R. 3200, 110th Cong. (1st Sess. 2007). The major change between the National Insurance Act of 2006 and that of 2007 is that the latter bill makes clear that health insurance is included among the types of insurance (life and property/casualty) that can receive a federal charter. For purposes of this Article, NIA will refer to the language in S. 40.

257. GovTrack.us, S. 40 [110th]: National Insurance Act of 2007, http://www.govtrack.us/congress/bill.xpd?bill=s110-40 (last visited Apr. 18, 2009).

258. Press Release, Rep. Melissa Bean, Bean and Royce Push for Insurance Reg Reform (Apr. 2, 2009), *available at* http://www.house.gov/apps/list/press/il08_bean/04_02_09_nicpa.html [hereinafter Bean Press Release].

259. National Insurance Consumer Protection Act, H.R. ____, 111th Cong., (1st Sess. 2009), *available at* http://www.house.gov/apps/list/press/il08_bean/National_Insurance_Consumer_Protection_Act_Bean_Royce.pdf [hereinafter NICPA]. Unlike the NIA, the NICPA only would provide charters for life and property/casualty insurers and reinsurers, not health insurers and reinsurers. *Id.* § 301.

260. *Id.* § 101(a).

261. *Id.* § 101(b)(1)–(2).

262. *Id*. §§ 102, 111–17, 301, 401, 501–03.

by the ONI would preempt state laws for the ONI-regulated entities with regard to licensing, examinations, reporting, and regulations concerning the sale or underwriting of insurance, but would not preempt state laws governing property, taxes, workers' compensation, or motor vehicle insurance.[263] Although insurers subject to state regulation would retain the antitrust exemption under the McCarran-Ferguson Act, national insurers and other entities regulated by ONI would lose this exemption except in connection with the development and use of standardized forms, or to the extent that they are subject to state law.[264]

Furthermore, the ONI would give the federal government the power to negotiate international agreements establishing standards for national insurers without necessarily requiring that such agreements preempt state law.[265] Under the Act, the commissioner may engage in negotiations regarding international or multilateral agreements covering insurance but he is required to consult with the president and the U.S. trade representative.[266] Unlike the NIA, the NICPA does not expressly state that the commissioner may include a state insurance regulators' representative in such negotiations, although it does not prohibit him from doing so.[267]

While the NICPA would improve the ability of the United States to negotiate international agreements on insurance regulation, Congress probably will not enact it without making significant changes to its consumer protection provisions. The NIA failed to be enacted by the 110th Congress, in part, due to concerns over the weakness of the consumer protections provided for in the Act. Representative Barney Frank, who chairs the House Financial Services Committee, was on record as opposing any optional federal charter bill that does not adequately protect consumers.[268] Unfortunately, the sponsors of the NICPA have made cosmetic changes, such as inserting "Consumer Protection" into the name of the Act, to try to hide the fact that the NICPA actually provides even weaker consumer protections than the NIA.

The name of the NICPA is misleading. It implies that the Act is based on the Insurance Consumer Protection Act of 2003 ("ICPA"),[269] which

263. *Id*. §§ 109, 321–23.

264. *Id*. § 702.

265. *Id*. § 203.

266. *Id*. § 203(c).

267. *Compare id.* § 203(c), *with* NIA, *supra* note 256, § 1102(b)(5)(C).

268. Press Release, Networks Fin. Inst., Ind. State Univ., 4th Annual Insurance Reform Summit: Optional Federal Charters, Consumer Protection and Terrorism Insurance Dominate Discussion (Mar. 8, 2007), *available at* http://www.networksfinancialinstitute.org/News/Pages/PressReleasesArchive.aspx?PressReleaseID=7.

269. Insurance Consumer Protection Act of 2003, S. 1373, 108th Cong. (1st Sess. 2003) [hereinafter ICPA].

former Senator Fritz Hollings of South Carolina introduced into the 108th Congress. The ICPA differs significantly from the NICPA. First, the ICPA required national insurers to be regulated by the federal government; it did not allow them to engage in regulatory arbitrage by allowing them the option of choosing their regulator as the NIA does.[270] Second, the ICPA would have repealed the McCarran-Ferguson Act and eliminated the insurance industry's antitrust exemption while the NICPA only provides for a limited repeal of the exemption for nationally chartered insurers.[271]

Third, the ICPA brought up to the federal level most of the major state consumer protection regulations, including price regulations on insurance products and services.[272] The NICPA, on the other hand, eliminates price regulation of insurance products for nationally chartered insurers and only requires the commissioner to adopt by regulation the market conduct standards found in two NAIC model laws, the Unfair Trade Practices Act and the Unfair Claims Settlement Practices Act.[273] This is a major departure from state regulation as every state but Illinois has some form of price regulations for insurance products.[274] The NICPA requires the commissioner to consider NAIC standards, model laws, practices, and procedures when formulating regulations for ONI-regulated entities, but does not require that he actually adopt NAIC standards with regard to accounting and disclosure, auditing, risk management, internal controls, investments, capital and liquidity, actuarial opinions, or reinsurance.[275]

While the absence of price regulations is consistent with NIA,[276] the NICPA's requirements regarding NAIC standards appear weaker than the NIA's provisions. The 2006 and 2007 versions of the NIA would have required the commissioner to promulgate consumer protection regulations consistent with the standards and model laws developed by the NAIC.[277] The commissioner would have two years to issue these regula-

270. *Id.* § 211; NICPA, *supra* note 259, §§ 301, 303.

271. ICPA, *supra* note 269, § 283; NICPA, *supra* note 259, § 702.

272. ICPA, *supra* note 269, §§ 221–23, 231–38, 281–83.

273. NICPA, *supra* note 259, §§ 109(b)(3)(C), 313(a). The NIA also prohibited the ONI from promulgating price regulations on insurance products. The absence of price regulations in both bills is due to the fact that these bills are based on legislation originally proposed in 2001 by the American Council of Life Insurance, the American Bankers Insurance Association, and the American Insurance Association. NATIONAL INSURANCE ACT OF 2001 (Am. Bankers Ins. Ass'n, Proposed Legislation 2001), *available at* http://www.aba.com/aba/pdf/ABIA_OFCL2001Draft.pdf.

274. Bean Press Release, *supra* note 258.

275. NICPA, *supra* note 259, § 314.

276. *See* NIA, *supra* note 256, § 1125 (lacking price regulations).

277. *Id.* § 1212.

tions, and they would have to remain in place for five years after their effective date.[278] After this five-year period, the commissioner would be free to set whatever consumer protections standards that he chose. These provisions cover a broader range of NAIC models and put limits on the commissioner's ability to amend the regulations implementing these model laws at the federal level. In contrast, the language in the NICPA only requires the commissioner to adopt two NAIC model laws by regulation and does not appear to put any limits on the commissioner's ability to amend these regulations after they are adopted.

It is doubtful that Representative Frank and others, such as the Consumer Federation of America, who were uncomfortable with the level of consumer protections in the NIA, will find the NICPA acceptable.[279] As a result, it is unlikely that the Congress will enact the NICPA without substantially amending its consumer protection provisions.

3. Delegating Negotiating Authority

Another way of correcting the problem that the U.S. regulatory structure for insurance poses for concluding binding international agreements would be to have Congress pass a law allowing the states, either directly or through the NAIC, to negotiate international insurance agreements.[280] Even if Congress gives this authority to the NAIC, it will not completely correct the problem because the NAIC currently has no power to force the states to adopt any standards that it espouses. In order to create binding international agreements, all of the states would have to consent to be bound by any agreement that the NAIC concluded and to adopt the laws necessary to implement it.

Allowing the individual states to negotiate directly with foreign nations concerning international insurance regulatory standards would be problematic. First, states would need to be convinced that undertaking such negotiations is in their interests. As previously mentioned, state legislatures typically include little or no funds within insurance commission budgets for the promotion of international cooperation on insurance mat-

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278. *Id.* § 1212(c).

279. The Consumer Federation of America has consistently opposed the adoption of a dual insurance chartering system on the grounds that it "would create a federal regulation that would have little if any authority to regulate price or product" and would merely enact a "wish list of insurer interests." David Hess, *Insurers Split over Federal Regulation Proposal at Hearing*, CONGRESSDAILY, Oct. 23, 2003.

280. U.S. CONST. art. I, § 10 allows states to enter into agreements with foreign powers with the consent of Congress. Since the NAIC is a collective organization of state insurance commissioners, allowing it to negotiate with foreign nations may fall within this part of the U.S. Constitution.

ters. Second, other nations are unlikely to want to deal with fifty different state actors. For example, it is not clear that international organizations like the WTO would accept a delegation comprised of fifty representatives, each from a different state with different negotiating positions. Given their inability to adopt uniform standards within the United States, they probably would not be willing or able to agree on a uniform position for international negotiations.

These negotiations between states and other nations could be further complicated if Congress decides to pass a law allowing insurers to be licensed in any state, but to operate in all fifty states.[281] Such a law would make insurance regulation in the United States look like the laws governing incorporation. The advantages of such a scheme are that it would allow insurers to deal with a single set of rules because they would only have to comply with the insurance laws of the state in which they are chartered, while encouraging regulatory competition among states.[282]

The true desirability of this type of regulatory competition depends on whether it encourages a race-to-the-top or a race-to-the-bottom. It is likely that creating this kind of regulatory competition in the insurance sector would produce a race-to-the-bottom because insurance companies would probably seek out the state with the weakest regulatory standards in order to maximize their profits.[283] Consumers certainly could try to apply market pressure on companies by not buying insurance from those chartered in extremely weak regulatory regimes. It is doubtful, however, that consumers will know or understand the differences in the insurance regulatory regimes of all fifty states well enough to make informed decisions.

Such competition is likely to produce winners and losers and, in effect, narrow the field of states with which foreign governments would feel the

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281. Butler and Ribstein have proposed such a reform. *See* Butler & Ribstein, *supra* note 200, at 36.

282. *Id*.

283. Butler and Ribstein recognize that this is a potential problem. They have tried to build in safeguards that would provide a floor level of regulation in the areas of solvency regulation and consumer protection. *Id*. at 40–41. These minimum regulations do not prevent a race to the bottom; they only restrict how much deregulation states will be allowed to engage in to attract insurance firms to license in their jurisdictions. The limits set by Butler and Ribstein are lower than what states like New York and California already require. For example, they do not appear to require that criminal background checks be part of the process to become licensed as an insurance provider. Both New York and California require criminal background checks for firms seeking to offer insurance within their borders. *See Hillman Testimony*, *supra* note 167, at 6 (specifically referencing California). As a result, consumers in those states would be worse off if insurers traded their New York and California licenses for licenses in states meeting the minimum requirements set by Butler and Ribstein.

need to negotiate. It is possible that one state could come to dominate insurance chartering the way that Delaware dominates corporate charters.[284] If this occurred, foreign nations would likely only negotiate with that state and perhaps the two or three other states with the largest insurance markets, such as California, Florida, New York, and Texas. Under these circumstances, the other states may feel compelled to adopt the same standards in order to maintain their competitive position, or at least avoid weakening it further.

Such a scheme runs counter to how the Framers of the Constitution envisaged U.S. foreign affairs. Article I of the Constitution gives Congress the power to "regulate commerce with foreign nations,"[285] and Article II gives the president the power to make treaties with the advice and consent of two-thirds of the Senate.[286] While the Constitution expressly permits the states to enter into international agreements with other nations with the consent of Congress,[287] this provision has rarely been utilized.

CONCLUSION

If moving from soft law norms and standards for insurance regulation to hard law in the form of treaties or binding international agreements is desirable, then the U.S. regulatory structure needs to be reformed to enable it to participate effectively in international negotiations. The current division between the states' ability to regulate insurance and the federal government's authority to conduct international negotiations has stymied efforts to date to move beyond the status quo in the area of insurance regulation. The easiest and most likely way to resolve this issue is for Congress to reintroduce and pass the Insurance Information Act.

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284. Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 590 (2003) (discussing Delaware's dominance).

285. U.S. CONST. art. I, § 8.

286. *Id.* art. II, § 2.

287. *Id.* art. I, § 10.