

An Overview of the Insurance Industry and Its Regulation

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Abstract

This paper provides a context for the discussion of reforming the framework of insurance regulation and its policies in the US. To assess the arguments surrounding the reform debate and related topics, it is helpful to have an understanding of the current structure of the insurance industry and how it is regulated. It is also helpful to understand how the industry and its regulation have evolved and consider their future paths. It is only within the last two decades that a significant segment of the industry has come to favor federal regulation over the current state-based system. This change in view stems from several factors, including the spreading geographic scope of insurance markets. It also reflects growing disenchantment with the perceived inefficiencies of a state-based system and its policies. At the same time, the states and other industry segments of the industry strongly oppose federal regulation, even if it is optional for insurers and intermediaries. The states contend that they have taken major steps to harmonize and streamline their regulatory requirements and that federal regulation (optional or mandatory) would not be in the best interest of consumers. This paper reviews how the organization of the industry has changed and discusses key factors pertinent to the push for reform and its merits. It also examines the current system for insurance regulation and recent state initiatives that are important in considering the need for and implications of alternative frameworks. Finally, an array of proposed or potential institutional structures for insurance regulation is outlined to identify the options available to policymakers.

I. Introduction

Insurance regulation in the US has been steeped in controversy over its 200-year history. In its early years, industry and regulatory failures prompted reforms and the coalescence of insurer oversight into a state regulatory framework. Beginning in the mid-1800s, both the industry and its state regulators have been subject to a series of federal challenges. The states' regulatory authority was reaffirmed in these challenges, most recently with the passage of the McCarran-Ferguson Act (MFA) in 1945. The MFA also established a limited antitrust exemption for insurers which is coordinated with its regulation.

However, as the insurance industry has evolved, its support for state regulation has eroded and significant industry segments now support the creation of an Optional Federal Charter (OFC) for insurance companies and agents that would preempt state

regulation for federally-chartered firms and also modify the antitrust law that applies to the industry. An OFC is strongly opposed by the states as well as certain industry groups (e.g., independent agents) with a vested interest in preserving the existing system and a fierce debate continues over the restructuring of the insurance regulatory framework and its policies. Questions also have been raised about the implications of eliminating or narrowing the industry's limited antitrust exemption in OFC legislation.

This paper examines the insurance industry and its regulation in the US to provide a context for the current debate on regulatory reforms. It is important to understand the historical evolution of insurance regulation, its current structure and how they have been affected by the interplay of economic and political factors. Both the structure of the industry and its present system of regulation have significant implications for reform proposals and the arguments of their proponents and opponents.

Section II outlines the structure of the insurance industry and how it has changed and discusses its future direction. This is followed by a review of the history of insurance regulation and the origins of the present system. Section IV examines how insurance is regulated currently and state initiatives to improve regulatory efficiency and forestall federal intervention. Section V offers a brief overview of alternative frameworks for insurance regulation that include but are not confined to an OFC. Section VI offers concluding thoughts.

II. The Structure of the US Insurance Industry

A. Evolution of the US Insurance Industry

Dramatic changes have occurred in the US insurance industry since its inception in the late 1600s (Hanson, Dineen, and Johnson., 1974). Initially, small local and regional carriers primarily writing fire and life insurance dominated the industry which led to a state-based regulatory framework. Since then, the industry has grown substantially in terms of the amount and variety of insurance products and the number of insurers. Companies of various sizes selling a vast array of products across state and national boundaries now populate the industry. Economic opportunities and competitive pressures have caused insurers to widen their geographic scope and take on increased financial risk. Over time, a wide range of insurance services have become available to buyers, reflecting the growing national economy and diversity of buyer needs and tastes for insurance protection. The evolution of regulatory institutions has been both compelled by as well as facilitated the development of the insurance industry.

The significant growth of the private insurance industry in the US is reflected in Figure II.1 that plots industry income (premiums and investment income) in constant dollars relative to gross domestic product (GDP) over the period 1960 to 2000. Total industry income increased from \$184 billion (measured in 2000 dollars) in 1960 to \$1.2 trillion in 2000, a 634 percent rise in real terms. The industry grew considerably faster than the overall US economy. The ratio of insurance income to GDP rose from 7 percent in 1960 to 12 percent in 2000.¹ On a value-added basis, insurance represented approximately 2.1 percent of total US GDP in 2006 as estimated by the Bureau of

¹ The comparison of industry income with GDP should be qualified because they are defined differently. Industry income essentially reflects all revenues flowing through the industry, while GDP only reflects the value added by each industry. Hence, the value added by the insurance industry, i.e., the value of the actual services provided by the insurance industry, is less than its revenues, which include benefit payments. However, the comparison does provide a crude indicator of the relative growth of insurance in terms of its control of resources.

Economic Analysis. Industry growth also is reflected in the rise in industry employment from 1.5 million in 1970 to more than 2.3 million in 2006 (Insurance Information Institute, 2008). However, the number of insurance companies has decreased from 4,580 in 1970 to 3,905 in 2006, reflecting industry consolidation (Insurance Information Institute, 2008).² Structural trends affecting the insurance industry are discussed in greater detail below for each major sector – property-casualty, health, and life insurance and annuities.

B. Property-casualty Insurance Markets

The nature of the property-casualty insurance business is very different today than it was 60 years ago. In the industry's infancy, local stock companies and mutual protection associations formed to provide property and fire insurance to a particular community (Hanson, Dineen, and Johnson, 1974). Over time, property-casualty companies expanded the types of insurance they offer and the geographic area of their operations. Property-casualty insurers now cover a wide range of exposures from residential fire to product liability. This has increased the complexity of the business and its risk.

One of the significant factors causing increased risk in property-casualty insurance is the long payout pattern for commercial liability lines, which makes proper pricing and reserving difficult and subject to manipulation. Shifting legal doctrines also increase the margin for error and insolvency risk. Cyclical pricing and periodic crises, prompted by severe loss shocks, have plagued the industry (Cummins, Harrington, and

² This estimate of the number of insurance companies may be somewhat conservative and does not include non-traditional insurers.

Klein, 1991). Significant cost inflation in certain commercial lines has induced some buyers to purchase coverage from alternative sources such as surplus lines insurers and risk retention groups or become self-insured, which increases competitive pressure on traditional insurers. Weather patterns, earthquakes and extensive building in high-exposure areas have also increased catastrophe hazards in property lines. Indeed, climate change poses a new set of threats to property-casualty insurers. Additionally, the industry must cope with shifts in “unnatural” perils such as terrorism and crises in financial markets. Greater risk and its impact on earnings will continue to challenge property-casualty and other insurers.

Table II.1 presents historical data on the portion of the property-casualty insurance industry represented by traditional or standard insurers. There are still a significant number of small, independent insurers selling property-casualty insurance in a limited geographic area. However, large national carriers now account for a larger share of many markets, relegating other insurers to niches they are better positioned to serve. The top ten property-casualty insurers accounted for 48.5 percent of direct premiums written in 2006, compared with 34.4 percent in 1960. Foreign companies also are making increasing inroads into the US domestic market while some US insurers are establishing a significant presence overseas. However, foreign penetration of the US market has been much greater than US penetration of foreign markets.³ Fierce competition has forced insurers in all sectors to streamline their operations and abandon unprofitable lines. A number of insurers appear to be selling off marginal segments of their business and

³ There are a number of factors that have contributed to this imbalance but one factor cited by US insurers is their regulation which they argue places them at a competitive disadvantage relative to foreign insurers.

concentrating on areas where they believe their core competencies and best opportunities lie. This is contributing to increased market concentration in certain lines of business.

The growth and increasing financial strength of the property-casualty insurance sector also are reflected in Table II.1. The assets of property liability insurers have increased from \$30.1 billion in 1960 to \$1.5 trillion in 2006. Commensurately, total premium and investment income has increased from \$15.7 billion to \$501.1 billion over this same period. Concurrently, the industry's leverage reflected by the ratio of net premiums to surplus has declined from 210.2 percent in 1970 to 89.3 percent in 2006.

One can see the conditions that are contributing to the restructuring and consolidation of the industry. The increasing capitalization of the industry, coupled with soft pricing, is prompting insurers to reassess their capital allocation. The number of insurance companies began to decline in the mid-1990s and mergers and acquisitions have increased dramatically. Some insurers and financial holding companies are bulking up to compete with other financial giants on a global basis. Other insurers are shedding marginal business segments and concentrating on core areas where they believe they have a comparative advantage. Although the industry is consolidating on the whole, this has not prevented the emergence of some "new players" targeting niche opportunities, e.g., property insurance in coastal states.

Figures reflecting the structure of property-casualty lines on a countrywide basis are shown in Table II.2. Personal auto and homeowners insurance represent almost one-half of total property-casualty premiums. In excess of 1,270 insurer groups (including stand-alone companies) sold property-casualty insurance in 2006, with several hundred

insurers competing in each major line.⁴ The principal measures of market concentration, the 10-firm concentration ratio (the market share of the top ten insurers) and the Herfindahl-Hirschman Index (the sum of the squared market shares of all insurers) also reflect competitive market structures in these lines. The top ten insurers accounted for less than 65 percent of the premiums in any given line, and 40 to 50 percent in many lines. Similarly, HHI values ranged from 255 to 651, with most lines falling between 300-500. These levels of concentration are considerably below levels that most economists consider necessary for firms to begin acquiring market power.⁵

Entry and exit barriers also appear to be low. Regulatory capital requirements are modest. Information and the cost of establishing distribution systems likely have a greater impact on entry and exit but these factors do not appear to impose significant barriers to many insurers.⁶ The ease of entry and exit is reflected in the high percentage of entries and exits in and out of these lines since 1997. These figures do reflect some industry and market restructuring as exits have exceeded entries in all lines shown except medical malpractice. This reflects the general consolidation of the industry and insurers' increased focus on markets where they believe they can be most successful. It should be noted that entry and exit barriers are somewhat higher at the state level than the national level, as insurers must apply for a license to write insurance in a particular state and incur additional costs to enter a state market.

⁴ These numbers do not include single-state and non-licensed insurers that do file financial statements with the NAIC. The numbers for medical practice also may exclude specialty insurers that do not report data to the NAIC.

⁵ The Department of Justice has established merger guidelines, which consider markets with HHIs in excess of 2,000 to be highly concentrated, and, hence, mergers in such markets are subject to closer scrutiny.

⁶ Information and expertise are arguably the most important resource to insurance companies. To be successful in penetrating any market, insurers must have a good understanding of the risks they will underwrite and price.

Table III.3 provides some interesting information on the relative shares of premiums written by domiciliary and non-domiciliary insurers in each state in 2006. In most states, non-domestic companies write from 60 to 90 percent of the total property-casualty premiums, with the weighted average at around 75 percent. This reflects the fact that most property-casualty insurance transactions cross state boundaries. This fact is a major driver of the interest in federal regulation and plays a prominent role in the arguments for offering insurers a federal alternative to the current state regulatory system.

Some information on profitability, one of the principal measures of market performance, is provided in Table III.4. With the exception of the years 1999-2002, insurers' return on net worth has generally averaged in the area of 10 percent which is below the rate of return earned in other industries (see Figure III.4).⁷ This reflects the highly competitive nature of the industry and suggests that insurers generally have not been earning excessive profits. Figures on loss ratios and historical (1996-2005 average) profits on insurance transactions by line in Table III.4 show fairly low profit margins.⁸ Profits in homeowners insurance have been negative over the last decade due to increased losses from catastrophes. While the industry's sub-par performance cannot be blamed solely on its regulation, many insurers would argue that the current regulatory system undermines their efficiency.

⁷ The low profits in the years 1999-2002 were generally due to the "soft market" in commercial lines. This reflects the industry's susceptibility to supply/price cycles as noted above.

⁸ The profit on insurance transactions, as calculated by the NAIC, reflects all insurer income (except investment income attributable to surplus), claim payments, expenses, and taxes, divided by net premiums earned.

C. Accident and Health Insurance Markets

As in property-casualty insurance markets, dramatic changes have occurred in the health insurance industry. Severe medical cost inflation and competition have led buyers to search aggressively for savings in their health insurance bills. The standard indemnity policy has declined as insurers have been compelled to redesign their products and services to allow buyers more cost-containment options. Many carriers now offer managed care programs and integrated service networks that involve alliances with doctors and hospitals. Insurers also have tightened their underwriting standards in order to lower prices for low-risk groups, which has decreased availability and raised premiums for less healthy groups. This transition of health insurance markets has been “bumpy” as some insurers have suffered from both significant cost inflation and strong competitive pressures. Further, the quality, price and availability of health insurance have become significant political issues that have sometimes led to additional regulatory constraints and mandates.

The explosion in medical costs over the last two decades has prompted a number of alternatives to traditional health insurers as source of medical coverage. These options include Health Maintenance Organizations (HMOs) and Preferred Provider Organizations (PPOs), among others. A number of employers have taken advantage of federal ERISA preemptions of state regulation to set up their own group health plans and contract with various providers and vendors for certain services to help them administer their plans.

A number of HMOs have been consolidated in the face of fierce competition and large losses.⁹ Some multi-line insurers also have sold their health care operations because

⁹ Economies of scale are particularly important for HMOs that must provide health services for its enrollees within a given community.

of poor performance. Federal and state governments have tightened enforcement of standards for quality of care. Hence, a shakeout is occurring which will result in a more concentrated, and perhaps more efficient, group of health care financing entities. As pressures increase to provide health coverage for uninsured Americans, the plans and programs that are eventually established could have significant implications for health insurers.

The data shown do not reflect developments in the markets for disability income and long-term care insurance. Both markets have grown, but their development has been hampered by certain challenges, especially those affecting long term care insurance. With the aging of the population and increasing longevity, the need for “custodial care” is rising rapidly. However, insurers have encountered difficulty in developing and selling attractive long-term care products. Many older Americans are reluctant to pay for LTC insurance, perhaps betting that they won’t need custodial care or will be able to cover its costs with their income and assets.

D. Life Insurance and Annuities Markets

For many years, life insurers’ products were primarily confined to standard term and whole life policies that emphasized death benefits and offered a modest savings component (for whole life policies). That environment has dramatically changed as life insurers now offer an expansive menu of life insurance policies, annuities and other interest-sensitive contracts with different risk-return characteristics. This shift is reflected in the fact that life insurers’ reserves for pension-related products (individual and group

annuities and supplemental contracts with life contingencies) grew from 27.2 percent of life-health insurance reserves in 1960 to 65 percent in 2006 (ACLI, 2008).

The increased significance of interest-sensitive products and insurers' greater exposure to disintermediation (i.e., policy loans, surrenders and lapses) has increased the importance of appropriate asset-liability matching strategies. At the same time, competitive pressures have induced insurers to maintain high crediting interest rates on their policies. A small number of life insurers have been stressed by their holdings of credit derivative instruments but most are sufficiently diversified in a broader array of assets and are unlikely to suffer significant losses due to recent developments in financial markets. Financial convergence is another significant development as various types of financial institutions offer both insurance and non-insurance products in competing for households' savings and investments.

Some general information on the development of the life-health insurance sector is provided in Table III.5. Since 1950, the number of life-health insurance companies increased from 649 to 2,195 in 1990 and then fell to 1,072 by 2006. Sector assets increased from \$64 billion in 1950 to \$4.9 trillion in 2006. Total annual income has increased from \$11.3 billion to \$883.6 billion over this same period. The dramatic shift in traditional life to annuity business is evident in the relative shares of income and reserves for these two segments. Due to the aging of the US population, it is expected that life insurers will continue to see dramatic growth in retirement-related products.

Table III.6 presents 2006 data on the structure of different segments of the life and annuity sectors, according to financial information reported by life insurers to the NAIC. As in the property-casualty sector, there are numerous insurers selling various life

and annuity products. A total of 460 life insurer groups (including stand-alone companies) reported to data to the NAIC and 100-300 insurers offer products in each of the major lines.¹⁰ In general, market concentration is relatively low in these broad lines and entry and exit activity relatively high. Exits have exceeded entries, consistent with industry consolidation and the decline in the number of life insurance companies and groups.¹¹ The data on the relative market penetration by domiciliary and non-domiciliary life-health insurers in Table III.7 also reflects a pattern similar to that for property-casualty insurers, with an even greater predominance of non-domestic insurers in each state.

III. A Brief History of Insurance Regulation

A. Early Origins

The current state regulatory framework for insurance has its roots in the early 1800s when insurance markets were generally confined to a particular community.¹² The high concentration of risk and the occurrence of large conflagrations led to highly cyclical pricing and periodic shakeouts when a number of property-casualty companies would fail after a major fire (Hanson, Dineen, and Johnson, 1974). Life insurers became notorious for high expenses, shaky finances and abusive sales practices (Meier, 1988). The local orientation of insurance markets at the time led municipal and state governments to establish the initial regulatory mechanisms for insurance companies and agents.

¹⁰ The number of insurer groups selling industrial life and health credit insurance are smaller but these are small and declining markets.

¹¹ Many exits may represent mergers and acquisitions of life insurers into large holding companies.

¹² See Day (1970), Hanson, Dineen, and Johnson (1974), Lilly (1976) and Meier (1988) for more detailed reviews of the history of state insurance regulation.

Government control of insurers was initially accomplished through special legislative charters and discriminatory taxation, but this proved to be an inefficient mechanism as the number of companies grew and the need for ongoing oversight became apparent (Meier, 1988). Insurance commissions were then formed by various states to license companies and agents, regulate policy forms, set reserve requirements, police insurers' investments, and administer financial reporting. Price regulation was essentially confined to limited oversight of property-casualty industry rate cartels.

Early on, the states recognized the need to coordinate their insurance regulatory activities. This led to the formation of the National Association of Insurance Commissioners in 1871. Its initial activities primarily focused on the development of common financial reporting requirements for insurers. State regulators also used the NAIC as a vehicle for discussing common problems and developing model laws and regulations which each state could modify and adopt according to its preferences.

Through the years, insurance department responsibilities grew in scope and complexity as the industry evolved. Two major forces appear to have heavily influenced the evolution of insurance regulatory functions and institutions. One factor has been the increasing diversity of insurance products and the types of risks that insurers have assumed. The other factor is the geographic extension of insurance markets with a number of carriers operating on a national and international basis. A third and more recent development has been significant consolidation within the life, health and property-casualty sectors as insurers have merged to achieve greater economies of scale and increase their financial capacity.

Arguably, the state regulatory framework is heavily challenged by such developments. Every state has had to increase its resources and expertise to oversee a more complex and geographically-extended industry. Table IV.1 provides summary information on the regulatory resources of each state and Figure IV.1 documents the increase in state insurance regulatory budgets and personnel. The states' reliance on the NAIC also has necessarily increased as a vehicle to pool resources and augment their regulatory activities. Consequently, the NAIC has been transformed into a major service provider as well as a mechanism for coordinating state actions and centralizing certain regulatory processes. Although the states have substantially increased their resources and the sophistication of their regulatory mechanisms, their critics raise concerns about the inherent inefficiency of a state-based framework and its ability to keep pace with the industry.

B. The State versus Federal Regulation Debate

Tension between the federal government and the states over the regulation of insurance dates back to the mid-1800s. This tension is created by the interstate operation of many insurers and their significant presence in the economy. On several occasions, the federal government has sought to exert greater control over the industry and the states have fought back aggressively to hold on to their authority, backed by the insurance industry. The economic and political stakes are high for both sides.

The primacy of the states' authority over insurance was essentially affirmed in various court decisions until the *Southeastern Underwriters* case in 1944. In that case, the US Supreme Court ruled that the commerce clause of the US Constitution did apply to insurance and that the industry was subject to federal antitrust law. This decision

prompted the states and the industry to join forces behind the passage of the McCarran-Ferguson Act (MFA) in 1945 which delegated regulation of insurance to the states, except in instances where federal law specifically supersedes state law. The MFA also granted a limited antitrust exemption to insurers tied to compensating regulatory oversight by the states.

Despite the passage of the MFA, federal interest in insurance regulation has continued to grow over time for several reasons. First, the insurance industry continues to play an important financial role in the nation's economy as financial markets have converged. Second, the performance of insurance markets affects interstate commerce and a number of areas of public policy staked out by the federal government, such as environmental pollution and health care. Third, periodic crises, such as the spike in insurer insolvencies in the 1980s, have fueled concerns about the adequacy of state insurance regulation and prompted debate about whether federal intervention would be necessary and a more efficient mechanism to remedy industry failures. Fourth, considering the vast resources commanded by the industry, it is only natural that some members of Congress might favor a stronger federal role in insurance in order to increase their authority and influence.

Historically, the industry strongly supported state over federal regulation. However, in recent years this has changed as the industry has continued to evolve. Increasingly, many insurers – especially those that operate on a national basis – have come to favor some form of federal regulation, such as an OFC. These insurers have become increasingly frustrated with the additional costs and burdens that they associate with the state system. They perceive that it would be less costly and more efficient for

them to deal with one central regulator than 56 jurisdictions.¹³ Insurers advocating federal regulation have not been satisfied with the states' efforts to "harmonize" and streamline their regulation that can only go so far before they undermine the states' arguments for preserving a state-based system. It should be noted, however, that the industry is not unanimous in its support of federal regulation. Many state and regional insurers, along with local agents, continue to support the state framework.

Although the primary regulatory authority for insurance still resides with the states, the federal government has affected state insurance regulatory policy and institutions in several ways. In a number of instances, Congress has instituted federal control over certain insurance markets or aspects of insurers' operations that were previously delegated to the states (e.g., health insurance, Medicare supplement insurance, etc.). In other cases, the federal government has established insurance programs (e.g., crop and flood insurance) which are essentially exempt from state regulatory oversight. Even the threat of such interventions has spurred the states to take actions to forestall an erosion of their regulatory authority.

The federal government also has set regulatory standards which the states are expected to enforce. In the case of Medicare supplement insurance, for instance, Congress enacted loss ratio standards which the states were required to adopt to avoid relinquishing their oversight authority to the federal government. Additionally, Congress also has significantly constrained state regulatory control over certain types of insurance entities, such as risk retention groups and employer-funded health plans, in order to increase coverage options in markets where the cost of traditional insurance is high. Finally, federal policies in a number of other areas such as antitrust, international trade,

¹³ See Pottier (2007) and Grace and Klein (2007).

law enforcement, taxation and the regulation of banks and securities have significant implications for the insurance industry and state regulation.

The most recent manifestations of the push for federal regulation are proposals for federal regulatory standards and an OFC for insurers that choose to be federally regulated. The states oppose both proposals, with their strongest opposition aimed at an OFC. They perceive that many insurers would choose an OFC which would effectively remove a large part of the industry from state oversight. State-oriented insurers and agent groups also strongly oppose an OFC, recognizing that it would reduce state entry barriers and enhance the competitive position of national insurers and producers. The OFC proposal is now the central focus of the state versus federal regulation debate.

C. The Evolution of State Insurance Regulation

Insurance regulation has been greatly affected by and compelled to evolve in response to changes in the industry and its economic and financial environment. One wave of reforms began in the late 1980s that were primarily aimed at strengthening solvency regulation. A large spike in the number and cost of insurer insolvencies in the mid-1980s led to an intensive Congressional investigation and a number of state regulatory initiatives. These initiatives included the strengthening of insurer financial standards, risk-based capital requirements, improved financial monitoring systems, and a program for certifying the adequacy of each state's solvency regulation. As insurer insolvencies fell, Congressional scrutiny diminished and the immediate threat to the state system seemed to subside.

However, growing industry complaints about the inefficiency and high cost of outmoded state regulatory policies warranted attention. This led to a second wave of

state/NAIC initiatives that continue through the present. The objective of these initiatives has been to streamline and harmonize state regulatory policies and practices to lessen regulatory cost burdens on insurers and coincidentally ease the pressure for federal regulation.

The states' efforts in this area have progressed in several phases. Beginning in the mid-1990s, the NAIC's Special Committee on Regulatory Re-Engineering identified several areas that warranted review, including company admission/licensing; special deposit requirements; countersignature requirements; deregulation of commercial lines; rate and form review; and other measures to improve the regulatory services received by insurance consumers. The committee issued a white paper in 1998 presenting its analysis and recommendations for further action by the relevant NAIC committees and the individual states. This was followed by subsequent NAIC reports in 2000, 2003 and 2005 that assessed the states' progress and set forth objectives for further improvements in the national system of state-based insurance regulation.¹⁴

During this period, several initiatives ensued or gained increased momentum, including:

- Enhanced consumer protection, encompassing the Consumer Information Source (CIS) Web site.
- More efficient market regulation, encompassing the *Market Analysis Handbook*.
- "Speed to Market for Insurance Products," encompassing the Interstate Insurance Product Regulation Commission (IIPRC) and the System for Electronic Rate and Form Filing (SERFF).
- Uniform forms and processes for producer licensing, encompassing the National Insurance Producer Registry (NIPR).

¹⁴ These reports are *Statement of Intent – The Future of Insurance Regulation* (March 2000), *A Reinforced Commitment: Insurance Regulatory Modernization Action Plan* (September 2003) and *2005 Regulatory Initiatives: Goals, Action Plans and Deadlines for States, Committees and NAIC Staff* (March 2005).

- Standardized insurance company licensing, encompassing the Uniform Certificate of Authority Application (UCAA).
- Improved solvency regulation, encompassing the Financial Data Repository (FDR).
- Streamlined changes of insurance company's control, encompassing the Form A Database.

In June 2004, the NAIC issued a “roadmap” that identified 15 areas where it believes national standards can be implemented by the states to provide a streamlined and seamless system of effective insurance regulation across the United States. The areas identified include:

- Market Conduct Uniform Standards
- Company Licensing
- Agent Licensing
- Life Insurance
- Property/Casualty Commercial Insurance
- Property/Casualty Personal Lines
- Surplus Lines
- Reinsurance
- Antifraud Network
- McCarran-Ferguson Antitrust Exemption and Rate Regulation
- State-National Insurance Coordination Partnership
- Viatical Settlements
- Interstate Compact for Health Insurance Products
- Enhancing Financial Surveillance
- Receivership

While these initiatives are impressive, they have failed to satisfy many insurers' demand for a true national regulatory system. In all of the initiatives listed above, each state still retains the authority over licensing applications, rate and product filings, etc. according to its specific regulations and judgments. It is difficult to see how insurers' desire for a common regulatory system can be reconciled with the

states' desire to retain their individual authorities to regulate insurers and insurance markets.

IV. Current Framework for Insurance Regulation

A. Structure

The regulatory framework is not confined to insurance departments but extends to all levels and branches of government. The major authorities in the current regulatory system are: 1) state insurance departments; 2) the courts; 3) state legislatures and the Congress; and 4) the executive branch at the state and federal level. Insurance has the additional complexity of both federal and state government authorities which are involved in the regulation of the industry.¹⁵

The state legislature establishes the insurance department, enacts insurance laws and approves the regulatory budget. Insurance departments are part of the state executive branch, either as a stand-alone agency or as a division within a larger department. Commissioners must often utilize the courts to help enforce regulatory actions, and the courts in turn, may restrict regulatory action. The insurance department in a given state must coordinate with other state insurance departments in regulating multistate insurers and rely on the NAIC for advice as well as some support services. The federal government overlays this entire structure, currently delegating most regulatory responsibilities to the states, while retaining an oversight role and intervening in specific areas.¹⁶

¹⁵ See Klein (1995) and (2005) for more detailed reviews of state insurance regulation.

¹⁶In practice, the federal government has left the principal regulatory functions for insurance to the states.

Most commissioners are appointed by the governor (or by a regulatory commission) for a set term or “at will,” subject to legislative confirmation. Typically, the governor and other higher administration officials do not interfere with daily regulatory decisions, but may influence general regulatory policies and become involved in particularly salient issues. Twelve jurisdictions elect their insurance commissioners who are more autonomous in the sense that they are not appointed by their governors but they must still cooperate with the administrations and legislatures in their states in order to achieve their objectives. Regulatory policy is formulated collectively by the insurance commissioner and the administrative branch, the legislature and the courts.

B. Regulatory Functions

Insurance regulatory functions can be divided into two fundamental areas: 1) financial or solvency regulation; and 2) market regulation. Beyond these two fundamental areas, state insurance departments engage in certain other activities, such as providing consumer information, to facilitate competition and better market outcomes. Such activities can be important in promoting regulatory objectives and potentially lessening the need for more intrusive regulatory constraints and mandates. However, the states do not view these activities as substitutes for active regulatory oversight and enforcement actions. The most important aspects of financial and market regulation are summarized below and diagrammed in Figure IV.2.

1. Financial Regulation

Protecting policyholders and society in general against excessive insurer insolvency risk is the state primary goal of insurance regulation. Regulators protect

policyholders' interests by requiring insurers to meet certain financial standards and to act prudently in managing their affairs. To accomplish this task, insurance regulators are given authority over insurers' ability to incorporate and/or conduct business in the various states. State statutes set forth the requirements for incorporation and licensure to sell insurance. These statutes require insurers to meet certain minimum capital standards and financial reporting requirements and authorize regulators to examine insurers and take other actions to protect policyholders' interests. Solvency regulation polices a number of aspects of insurers' operations, including: 1) capitalization; 2) pricing and products; 3) investments; 4) reinsurance; 5) reserves; 6) asset-liability matching; 7) transactions with affiliates; and 8) management. It also encompasses regulatory intervention with insurers in financial distress, the management of insurer receiverships (bankruptcies), and insolvency guaranty mechanisms that cover a portion of the claims of insolvent insurers.

The primary responsibility for the financial regulation of an insurance company is delegated to the state in which it is domiciled. Other states in which an insurer is licensed provide a second level of oversight but, typically, non-domiciliary states do not take action against an insurer unless they perceive the domiciliary state is failing to fulfill its responsibility. The states use the NAIC to support and coordinate their solvency oversight and compel domiciliary regulators to move more quickly in dealing with distressed insurers if this proves necessary. This helps to remedy (but may not fully correct) the negative externalities associated with solvency regulation. An insurer's domiciliary state tends to reap the lion's share of the direct economic benefits of its operations (e.g., employment and payrolls) but the costs of its insolvency are distributed

among all the states in which it operates. Economic and political considerations could cause a domiciliary regulator to apply excessive forbearance in dealing with a distressed insurer.

The states rely heavily on a number of reports that insurers are required to file, including annual and quarterly financial statements. Insurer financial reports are subject to “Statutory Accounting Principles” (SAP) which differ somewhat from Generally Accepted Accounting Principles (GAAP). These reports are reviewed in “bench audits” by regulators and insurers’ financial data are analyzed using various automated tools and monitoring systems. Financial monitoring occurs at the state level for all insurers and is also performed by the NAIC for companies that write business in significant number of states. This analysis can trigger further investigation of an insurer if there are concerns about its financial condition. Insurers are subject to both periodic exams (conducted every 3-5 years) and targeted exams to address particular questions or issues.

Insurers are subject to both fixed minimum and risk-based capital (RBC) requirements. Fixed minimum standards are set by each state and average in the area of \$2 million. Each company’s RBC requirement is determined through formulas developed by the NAIC that apply various factors to accounting values. It is essentially a static system; US regulators do not require insurers to perform any kind of dynamic risk modeling.¹⁷ An insurer’s Total Adjusted Capital (TAC) – its actual capital with minor adjustments - is compared to its RBC to determine whether any company or regulatory actions are required. The RBC model law adopted by the states specifies certain authorized or mandatory regulatory actions that are tied to specific TAC/RBC ratios that

¹⁷ Life insurers are required to perform some stress testing of their policy reserves.

start at 200 percent and become progressively more severe as lower ratio triggers are reached.

Insurers that fail to comply with regulatory financial standards and/or are deemed to be in hazardous financial condition are subject to regulatory intervention that can be formal or informal. Formal interventions typically involve regulators seizing control of a company and can constitute conservation, rehabilitation and liquidation depending on the condition of the insurer and its prospects. It is not uncommon for an insurer's financial statement to be revised when regulators step in and, hence, regulatory measures can progress rapidly from simply controlling an insurer's transactions to its liquidation if restructuring or rehabilitation is infeasible.

The domiciliary regulator is primarily responsible for administering remedial actions or sanctions taken against an insurer, including the management of its receivership, and can exercise a fair degree of discretion with court approval. However, other states in which the insurer is licensed can bring pressure to bear on the domiciliary regulator to act more quickly and decisively if warranted. While this dual layer of financial monitoring has likely improved the states' regulation of insurer solvency, there is still evidence that domiciliary regulators have been allowed to exercise too much forbearance in some instances (See Grace, Klein and Phillips, 2002).

Every state has separate state guaranty associations for property-casualty insurers and life-health insurers. These associations cover a portion of the unpaid claims obligations of insolvent insurers in their respective states. Only certain lines of insurance are covered by these associations and there are maximum dollar limits on the amount of coverage for each claim with the exception of workers' compensation insurance.

Generally, insurance products purchased by individuals and small businesses receive greater coverage than those purchased by larger commercial insurance buyers. Guaranty association costs are assessed back against licensed insurers. The ultimate burden of these assessments fall on insurance buyers, taxpayers and the owners of insurance companies.

2. Market Regulation

The regulation of an insurer's market practices is principally delegated to each state in which it operates. Hence, each state effectively regulates its insurance markets. The scope of market regulation is broad (potentially encompassing all aspects of an insurer's interactions with consumers) and the states' policies can vary significantly. State regulation of insurers' prices or rates is a particularly visible and controversial topic. The rates for personal auto insurance, homeowners insurance and workers' compensation insurance are subject to some level of regulation in all the states. The extent of price regulation for other commercial property-casualty lines tends to vary inversely with the size of the buyer. The rates for certain types of health insurance may be regulated but the prices of life insurance, annuities and related products are only indirectly regulated through the product approval process.

Insurers' policy forms and products also tend to be closely regulated with the exception of products purchased by large firms. Other aspects of insurers' market activities, e.g., marketing, underwriting, and claims adjustment, generally fall within the area of "market conduct" regulation. A state may impose some specific rules regarding certain practices, such as constraining an insurer's use of certain factors in underwriting or mandating that they offer coverage to all applicants. Beyond this, regulation tends to be aimed at enforcing "fair practices" based on regulators' interpretation of what this

means. Monitoring and enforcement activities are typically implemented through investigating consumer complaints and market conduct examinations.

Producers or insurance agents are also regulated by the states. Producers must be licensed in each state in which they sell insurance and are required to pass tests to demonstrate their competence. They must also comply with continuing education requirements and are subject to regulatory sanctions if they violate regulations governing their conduct. Many insurance agents dislike the necessity of single-state licenses and strongly advocate a multi-state or national license. As noted above, the NAIC has sought to make it easier for producers to get licenses in multiple states but this is not satisfactory to agent groups.

Not surprisingly, market regulatory policies and practices are complex and also subject to the greatest criticism by insurers and economists. Further, this is an area where the states' most strongly defend their individual authorities and prerogatives. A number of factors influence a given state's policies, including the cost of risk and its political climate, among many others. Economists tend to have greater confidence than regulators and legislators in the ability of competitive insurance markets to produce efficient outcomes. Perhaps more importantly, political interests and social preferences are often at odds with the outcomes that a competitive insurance market would produce, such as risk-based prices. This difference in perspectives is fundamental to understanding the reasons for the fierce debate about insurance regulatory policies and the prospects for their reform.

It should be noted that while financial regulation and market regulation are often discussed separately, they are necessarily intertwined. The regulation of an insurer's

financial condition and risk has implications for its market practices and vice versa. This is an important consideration in discussing alternative regulatory frameworks and policy reforms. Proposed frameworks and other structural options vary in terms of the extent to which financial and market regulatory authority is vested in one entity or divided between federal and state governments. The potential for contradictory financial and market regulatory policies must be evaluated for different regulatory schemes.

V. Alternative Frameworks for Insurance Regulation

Debate continues over whether full oversight of the industry should be transferred to the federal government. Various proposals for some form of federal regulation (or greater federal involvement in state regulation) have been vetted over the years. The concept that is currently receiving the greatest attention and regulatory support is the establishment of an Optional Federal Charter that would allow an insurer or an agent to choose to be federally regulated and exempt from state regulation. Another concept that has been proposed but has received less attention is the enactment of federal standards for state regulation that would impose greater uniformity on the current system. These and other possible frameworks are described below.

A. Status Quo

A good place to start is the current system of state regulation. To many observers, some form of federal insurance regulation may be inevitable but the states and some interest groups would strongly disagree. Regardless of what observers think, opponents of federal regulation wield considerable political power and the prospects for any radical

changes in the near future are daunting. What might we expect to happen if the states continue to retain their regulatory authority, at least over the near term?

As discussed earlier, both industry pressures and the threat of federal intervention have compelled the states to embark on a set of ambitious set of policy and institutional reforms. The stated intent of these reforms is to streamline, harmonize and rationalize the current system of state regulation while preserving certain state prerogatives. In essence, the states are seeking to reduce as much of the inefficiency that has been associated with the state-based framework as politically and logistically possible.

This is an important qualification. Fundamentally, if the states wish to retain most of their discretion in how they regulate insurers' market practices, then there is a limit to how far harmonization can go. For example, if a state insists on retaining rate regulation, mandated coverages, and/or prohibitions on certain underwriting factors, there is no force other than the federal government or market pressures to compel it to do otherwise. Further, the NAIC's centralized systems for filing rates and policy forms, agent licensing, and other processes must accommodate differing state requirements and regulatory approvals and compliance are determined by each state, not the NAIC. Finally, the policy reforms supported by the majority of states fall far short of what the industry and many experts advocate.

There are some positive aspects of this picture. One is that the states have made substantial strides even if they fall short of what could be achieved under an alternative framework. A second observation is that the threat of federal intervention has tended to push the states in the right direction. Thirdly, while state inertia may thwart or delay beneficial policy reforms it also can discourage nationwide shifts in the opposite

direction. In other words, some would argue that it is better to fight excessive price regulation in a few states than to have a federal regulator establish such a policy in all states. Fourth, state regulators are close to the consumers they are sworn to protect and this may offer some benefits to the industry as well as consumers.

Hence, the current system, while inherently inefficient and driven by local political winds, is still evolving and improving. Ironically, the strong push for federal regulation plays a significant role in compelling this evolution. Like it or not, this is the system that insurers may have to live with for some time to come. In such a scenario, regulatory reform is likely to incur incrementally both at the state and federal level.

B. Federal Standards

One approach to increasing the federal role in insurance would involve creating federal standards for state regulation. This concept was embodied in a draft legislative proposal released in 2004 - the State Modernization and Regulatory Transparency (SMART) Act – by Representatives Michael Oxley (R-OH) and Richard Baker (R-LA). The proposed legislation would establish minimum standards that would govern various aspects of state insurance regulation. Federal rules would preempt state regulations that fail to comply with the minimum standards after specified time periods.

The areas of insurance regulation encompassed by the SMART Act include, but are not limited to:

- Market conduct;
- Rates and policy forms;
- Insurer and produce licensing;
- Surplus lines;

- Reinsurance;
- Financial surveillance; and
- Receiverships.

Essentially, all lines of insurance and industry sectors would be covered by the Act. A State-National Insurance Coordination Partnership would be charged with determining state compliance with the federal standards and resolving disputes among government agencies.

This proposal has two principal objectives. One, it would compel the states to establish a level of regulatory uniformity that they might not otherwise achieve. Two, it would dictate insurance regulatory policies in a number of areas. The dual nature of the proposal – framework reform and policy reform – is also characteristic of other proposals for federalizing insurance regulation.

Some might view the SMART concept as less intrusive and ambitious than other proposals that would establish a federal regulator, although it is still opposed by the states and consumer groups.¹⁸ Under SMART, the states would still have the responsibility for insurance and regulatory oversight and enforcement, as well as retain some discretion in regulatory policy within the limits of the federal standards. As Harrington (2006) observes, SMART would avoid the establishment of a federal regulator and its associated bureaucracy. Further, it could avoid significant policy swings that would undermine market efficiency and harm consumers. The term “could” is an important qualifier as the enactment of the SMART Act would not preclude subsequent congressional changes to its minimum standards.

¹⁸ See Harrington (2006) for a comparative review of different options and proposals for federalizing insurance regulation.

At the same time, Harrington identifies a number of potential disadvantages to SMART. From a framework perspective, one of the principal concerns is that SMART could prove to be an administrative, monitoring and enforcement nightmare. Some states might seek to circumvent the standards and there would be the prospect of protracted and costly disputes regarding states' compliance with the standards. SMART could be simplified and its scope narrowed, but this would also undermine its objectives of greater uniformity and policy reform. This reflects the fundamental tension between uniformity and the states' prerogative to regulate insurance as they see fit.

The policy changes contemplated under SMART are broad in scope and, arguably, are its principal objective. The thrust of these reforms is to substantially deregulate many areas of insurance and lessen regulatory constraints in others. The states and consumer groups oppose a number of these changes, arguing that they gut essential consumer protections. The proposed reforms are outlined at a relatively high level in the draft document. If a legislative version was introduced in the Congress, it would likely be much more detailed and specific and subject to intensive discussion and modification. At this time, it appears unlikely that any version of the SMART Act will be introduced as the industry is placing its bets on OFC legislation. Still, the concepts and policies embodied in SMART could emerge in an OFC bill as it proceeds through its legislative gauntlet.

C. Optional Federal Charter

The vehicle for the OFC approach is the National Insurance Act (NIA) – S. 40 – introduced in 2007 by Senators John Sununu (R-NH) and Tim Johnson (D-SD).¹⁹ While there are many details that may or may not be in a final bill enacted by Congress, there are a number of important provisions that are likely to be present in any legislation that is enacted.

The NIA would set up the Office of National Insurance (ONI) regulator within the Department of the Treasury akin to the Office of the Comptroller of the Currency (OCC). The ONI's functions would be funded by an assessment on the insurers it regulates. The NIA permits both life and non-life insurance companies and agents to apply to the ONI for a charter and license to sell particular products in all states. It further permits the ONI to regulate the solvency and market conduct of insurers within its jurisdiction. Additionally, it authorizes the Commissioner of National Insurance to establish a comprehensive insolvency resolution scheme which includes the state guaranty associations (funds) which meet minimum qualifications.

Thus, the ONI would oversee solvency, policy forms, other aspects of market conduct, and insurer insolvencies. It would not regulate prices (except that prices and reserves have to be based upon sound actuarial principles) or underwriting standards. Further, assuming that the states' solvency guarantee system is adequate, a national insurer would participate in the state solvency guaranty association. If a state system does not qualify, there would be a federal plan that would cover these insolvent OFC insurers' obligations in the state.

States would not be able to discriminate against federally-chartered insurers or agents. States would still be permitted to tax insurers under current tax law with the

¹⁹ SB 2106 109th Congress.

qualification that no national insurer or national agency would be taxed differently than insurers domiciled in a state. This would preserve both state premium taxes and the special aspects of their retaliatory taxes.

National insurers or agencies would also be allowed, under the NIA, to choose their state of domicile which could be different than the state where the company has its headquarters if the company so desires. In addition, the NIA would permit insurers to choose the law under which their insurance contracts are interpreted. Additionally, the NIA would subject the industry to the antitrust provisions specifically exempted under the MFA with the exception that insurers would still be able to share information about losses or claim payments.²⁰

It should be noted that there is a distinct possibility that legislation will be introduced for an OFC that would apply only to life insurers. There appear to be fewer legislative concerns about (and perhaps less political opposition to) a life-only OFC. Life insurance products tend to be more standardized across states and life insurance is subject to less state-specific preferences, e.g., price regulation, than property-casualty insurance. Of course, property-casualty insurers who support an OFC would be greatly disappointed if a life insurance OFC took precedence over an OFC for all insurers. However, this could become a reality.

Proponents of an OFC argue that it would significantly decrease the cost burdens of and inefficiency caused by state regulation. OFC advocates also are hoping that it would result in significant policy reforms. Most important, rate regulation would be

²⁰ This is more pertinent to non-life insurance than life insurers. Life insurers do not use statistical agents to compile industry data on the amount of benefits they pay, although this information is reported in their public financial statements filed with regulators and others. Life insurers use mortality tables published by the NAIC as a reference to assist them in pricing life insurance policies and annuities.

eliminated for OFC-regulated insurers – a major concern of property-casualty insurers. OFC policies in other areas are more difficult to predict, but additional reforms are possible. These reforms could encompass more efficient and effective solvency oversight and market conduct regulation.

However, there is no assurance that the federal government would establish and sustain the policies that OFC proponents envision. There are a number of instances where the Congress has intervened and required the states to impose additional regulatory constraints on insurers in certain areas such as health insurance and other such measures have been discussed. Consumer advocates and economists can debate whether such policies are welfare-enhancing but the federal government is not immune from interest group pressures and excessive and unsound regulatory actions.

Despite a strong push from many segments of the insurance industry for an OFC, the states and certain industry groups – independent insurance agents and state/regional insurance companies – present a formidable opposing force. The current Administration and some members of Congress have expressed their support for the OFC but this has not been sufficient to release OFC legislation from its political tar pit. The inclusion of an insurance OFC in the blueprint for financial regulatory reform recently issued by the Treasury has drawn additional attention to the debate about the appropriate framework for insurance regulation and may add impetus to its legislative consideration.

D. Other Schemes

There are a number of other potential regulatory frameworks that have been discussed or might be considered. One such framework would allow an insurer to choose one state as its regulator (Harrington, 2006; Butler and Ribstein, 2008). There are several

potential advantages to such an approach. One is that it an insurer would be subject to a single regulator and one set of rules. A second advantage is that it would make use of the existing state insurance regulatory agencies and avoid the need for creating a new federal bureaucracy. A third advantage envisioned by those favoring such an approach is that it would promote healthy regulatory competition among the states. It is argued that the states would have an incentive to establish good regulatory systems to attract or retain insurers within their jurisdictions.

Another system that has been discussed would delegate solvency regulation to the federal government and market regulation to the states. The appeal of this kind of system is that a single federal regulator might be best positioned to oversee the financial condition and risk of multistate insurers and some might believe that the states are best positioned to deal with other consumer protection issues within their respective jurisdictions. Further, there is some precedent for this kind of federal-state system in the financial services industry as well as certain other countries, e.g., Canada and Australia.

This discussion has omitted other proposals that have been offered. These include the Insurance Consumer Protection Act, a mandatory federal charter for insurance companies, and a National Insurance Information Office. While these other proposals are not in forefront of current discussions, some of their elements could appear in future initiatives to reform the framework for insurance regulation. Legislation has been recently introduced that would establish a federal Insurance Information Office (IIO) with the Treasury, so it may garner some attention while the industry continues to press

for an OFC.²¹ It is difficult to predict the exact course of future legislation and variety of options could come into play as the process progresses.

VI. Summary and Conclusions

A state-based system for insurance regulation may seem somewhat incongruous in a modern financial system but its historical roots are strong and deep in the US. Arguably, insurance regulation has many facets and is complex. These characteristics, combined with a well-established state institutional structure and strong political opposition to federal regulation, may cause some legislators to pause in considering “radical” changes to the current framework. Still, the push for an OFC or something like it will continue as well as the intensive debate that surrounds it. The better policymakers understand the context for this debate, the better positioned they will be to evaluate the arguments they encounter and the decisions they must make.

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²¹ The political strategy behind the IIO legislations and its implications for the enactment of an OFC are unclear. It could be viewed as a more benign intermediate step to help set the stage for an OFC. Some OFC proponents might resign themselves to such a scenario, but others may be concerned that it will undermine the impetus for an OFC. It is possible that an IIO could lengthen the time frame for OFC legislation, but the OFC push will remain strong and an IIO could help pave the way an OFC in the long term.

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Table III.1
Property-casualty Insurance Trends: 1960-2006

	1960	1970	1980	1990	2000	2006
No. of Companies	NA	2,800	2,953	3,899	3,215	2,648
Assets (\$M)	30,132	55,315	197,678	556,314	1,034,090	1,483,013
Revenues (\$M)	15,741	36,524	108,745	252,991	341,590	501,106
Net Premiums Written (%)	95.1	94.3	89.6	86.9	87.7	89.3
Investment Income (%)	4.9	5.7	10.4	13.1	12.3	10.7
Market Share of 10 Largest Insurer Groups (%)	34.4	36.8	38.2	40.3	43.7	48.5
Premiums/Surplus (%)	125.5	210.2	183.4	157.6	75.6	89.7
Return on Net Worth (%)	NA	11.6	13.1	8.5	6.5	13.4
Source: Insurance Information Institute						

Table III.2
Property-casualty Insurance Market Structure (2006)

Line	Number of Insurers	Pct. of Sector DPW	CR10(%)	HHI	Since 1997	
					Entries(%)	Exits(%)
Personal Auto	389	33.2%	64.1%	651	29.4	48.9
Commercial Auto	389	6.2%	44.4%	272	33.4	46.2
Homeowners	438	12.3%	64.2%	784	27.9	41.2
Fire & Allied	544	4.2%	53.7%	502	24.8	41.6
Commercial MP	365	7.4%	49.0%	318	24.1	45.6
General Liability	697	12.2%	57.7%	595	36.8	42.8
Medical Malpractice	225	2.5%	45.8%	295	112.4	57.2
Workers' Compensation	312	9.5%	54.2%	487	32.1	48.0
Other	715	20.0%	43.1%	255	26.2	45.8
All Lines Combined	1,270	100.0%	48.6%	318	43.5	43.4
Source: NAIC Data and A.M. Best's Key Rating Guide						

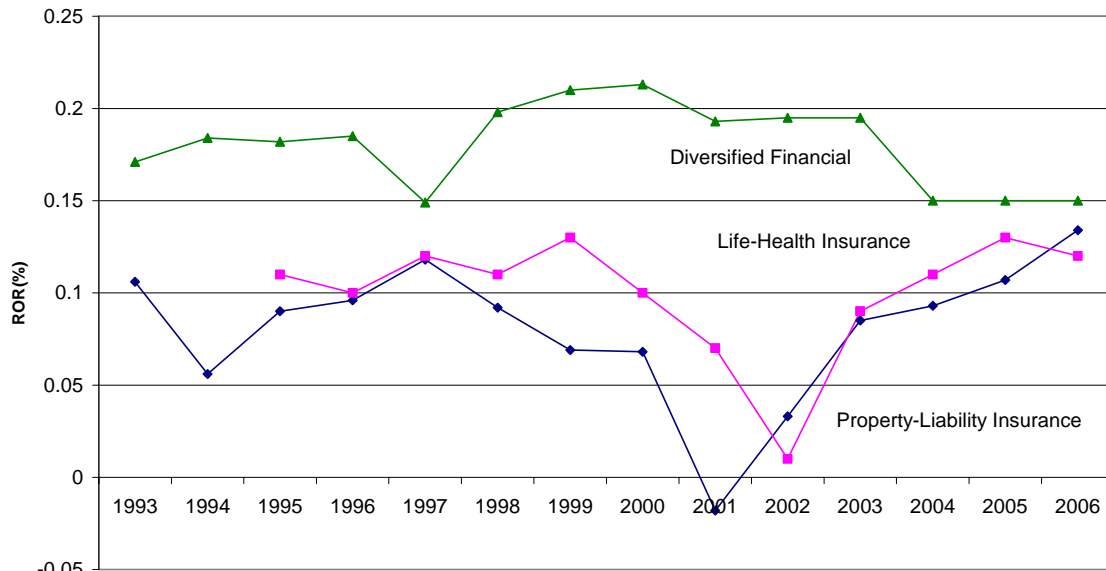
Table III.3			
Direct Premiums Written by Non-Domestic Property-Liability Insurers			
By State in 2006			
State	Premiums Written by		Non-Domestic
	Domestic Companies	Non-Domestic Companies	Market Share (%)
Alabama	960,140,814	5,633,368,769	85.4
Alaska	199,073,287	1,326,309,523	86.9
Arizona	784,507,535	7,684,470,329	90.7
Arkansas	225,406,700	3,687,605,735	94.2
California	18,476,141,444	41,325,400,747	69.1
Colorado	318,006,417	7,414,151,021	95.9
Connecticut	1,159,681,584	5,892,575,976	83.6
Delaware	293,658,907	2,069,795,401	87.6
Dist. Columbia	34,573,764	1,499,298,480	97.7
Florida	10,703,312,702	28,341,801,727	72.6
Georgia	1,525,419,120	12,380,639,913	89.0
Hawaii	727,497,055	1,597,694,859	68.7
Idaho	286,125,255	1,567,678,247	84.6
Illinois	9,279,732,130	11,874,180,974	56.1
Indiana	1,363,404,594	7,150,200,213	84.0
Iowa	1,146,817,315	3,425,251,422	74.9
Kansas	488,023,038	4,052,269,830	89.3
Kentucky	984,111,055	4,821,562,698	83.0
Louisiana	1,661,060,873	7,090,655,905	81.0
Maine	457,457,203	1,515,481,541	76.8
Maryland	1,236,942,435	7,719,661,243	86.2
Massachusetts	5,243,218,893	6,639,899,899	55.9
Michigan	7,205,703,810	8,114,813,197	53.0
Minnesota	924,741,008	7,745,520,222	89.3
Mississippi	502,048,337	3,670,694,377	88.0
Missouri	1,097,599,585	7,956,990,523	87.9
Montana	27,744,210	1,530,069,650	98.2
Nebraska	382,761,886	2,789,080,106	87.9
Nevada	243,628,746	4,351,300,716	94.7
New Hampshire	278,220,809	1,877,017,495	87.1
New Jersey	5,017,772,536	12,339,873,743	71.1
New Mexico	154,322,435	2,410,956,362	94.0
New York	8,613,369,469	26,104,575,059	75.2
North Carolina	1,836,157,736	9,977,224,870	84.5
North Dakota	163,328,226	1,142,870,091	87.5
Ohio	5,049,116,034	8,265,064,920	62.1
Oklahoma	751,286,657	4,499,132,418	85.7
Oregon	1,380,962,536	4,052,242,598	74.6
Pennsylvania	4,953,341,519	15,013,047,840	75.2
Rhode Island	361,172,066	1,581,234,985	81.4
South Carolina	370,493,137	6,218,784,461	94.4
South Dakota	75,346,971	1,381,121,923	94.8
Tennessee	1,174,449,321	7,216,198,614	86.0
Texas	14,760,141,813	19,960,335,380	57.5
Utha	430,183,750	2,846,911,603	86.9
Vermont	122,420,815	988,759,500	89.0
Virginia	333,919,068	10,287,049,724	96.9
Washington	1,629,453,680	7,198,468,407	81.5
West Virginia	892,213,671	2,189,954,125	71.1
Wisconis	3,673,436,736	4,343,889,876	54.2
Wyoming	60,703,862	775,488,036	92.7
Guam	100,803,619	17,461,504	14.8
Puerto Rico	1,793,660,730	245,922,413	12.1
U.S. Virgin Islands	37,680,482	52,579,647	58.3
Total	120,020,352,549	361,538,625,273	75.1
Source: NAIC Data			

Table III.4
Property-casualty Insurance Market Performance: 1996-2005

Line	As a Percent of Net Premiums Earned		Profit on Insurance Transactions	
	Losses Incurred		2005	1996-2005
	2005	1996-2005	2005	1996-2005
Private Passenger Auto	59.1	64.5	6.0	2.7
Commercial Auto	53.5	65.5	9.5	1.0
Homeowners	60.5	65.9	2.2	-2.5
Farmowners	55.2	66.2	4.8	-2.5
Commercial Multi-Peril	49.4	59.5	6.7	-0.4
Fire	46.5	56.4	14.9	5.7
Allied Lines	104.4	77.3	21.2	-5.5
Inland Marine	52.3	51.8	8.5	6.3
Medical Malpractice	52.1	69.1	12.5	2.0
Other Liability	62.2	66.2	3.9	5.6
Workers' Compensation	65.4	68.3	9.1	4.9
All Lines	61.6	65.2	5.0	2.7

Source: NAIC Report on Profitability By Line By State 2005

Figure III.1
Rate of Return on Net Worth
Insurance and Diversified Financial Industries



Source: Insurance Information Institute

—◆— P-L Insurance —■— L-H Insurance —▲— Diversified Financial

**Table III.5
Life-Health Insurance Market Trends: 1950-2006**

	1950	1960	1970	1980	1990	2000	2006
No. of Companies	649	1,441	1,780	1,958	2,195	1,268	1,072
Assets (\$M)	64,020	119,576	207,254	479,210	1,408,208	3,185,945	4,882,884
% 10 Largest Insurer Groups	na	62.4	57.7	52.5	36.7	41.7	NA
Income (\$M)	11,337	23,007	49,054	130,888	402,200	826,660	883,597
% Life Insurance Premiums	55.1	52.1	44.2	31.2	19.1	15.8%	16.9%
% Annuity Considerations	8.3	5.8	7.6	17.1	32.1	36.7%	34.3%
% Health Insurance Premiums	8.8	17.5	23.2	22.4	14.5	12.8%	16.0%
% Investment Income	18.3	18.7	20.7	25.9	27.8	25.2%	27.1%
% Other	9.5	5.8	4.4	3.3	6.5	9.5%	5.9%
Policy Reserves (\$M)	54,946	98,473	167,779	390,339	1,196,967	2,711,420	3,607,743
% Life	na	71.9	68.8	50.7	29.1	27.4%	30.8%
% Annuities	na	27.2	29.1	46.5	68.1	69.1%	65.0%
% Health	na	0.9	2.1	2.8	2.8	3.5%	4.2%
Net Rate of Investment Income (%)¹	3.1	4.1	5.3	8.1	9.3	7.1	5.4
Capital Ratio (%)²	na	na	9.7	9.2	8.5	11.1	10.0
Return on Equity (%)	na	na	na	13.9	10.7	10.0	12.0

¹Net investment income divided by mean invested assets (including cash) less half of net investment income.

²Capital plus surplus plus Asset Valuation Reserve divided by general account assets.

Source: American Council of Life Insurance, Insurance Information Institute, A.M. Best.

Table III.6 Life Insurance Market Structure (2006)						
Line	Pct. of Sector Reserves	Number of Insurers	CR10	HHI	Since 1997	
					Entries(%)	Exits(%)
Life						
Industrial	-	67	93.0	2,970	25.3	51.6
Ordinary	27.4%	389	57.1	498	18.1	49.8
Credit	3.3%	103	72.8	779	19.5	56.7
Group	0.0%	245	72.3	1,160	19.2	55.6
Annuities						
Individual	42.2%	258	58.0	425	21.0	53.3
Group	22.4%	108	76.5	732	24.8	50.3
Supp Contracts	0.5%					
Accident & Health						
Group	2.9%	237	65.5	863	20.5	59.1
Credit	1.3%	76	78.4	1,099	13.6	56.1
Individual	0.1%	262	68.3	791	19.5	53.9
Other	-	2	100.0	8,409	66.7	100.0
All lines combined	100.0%	460	46.6	308	17.8	54.0

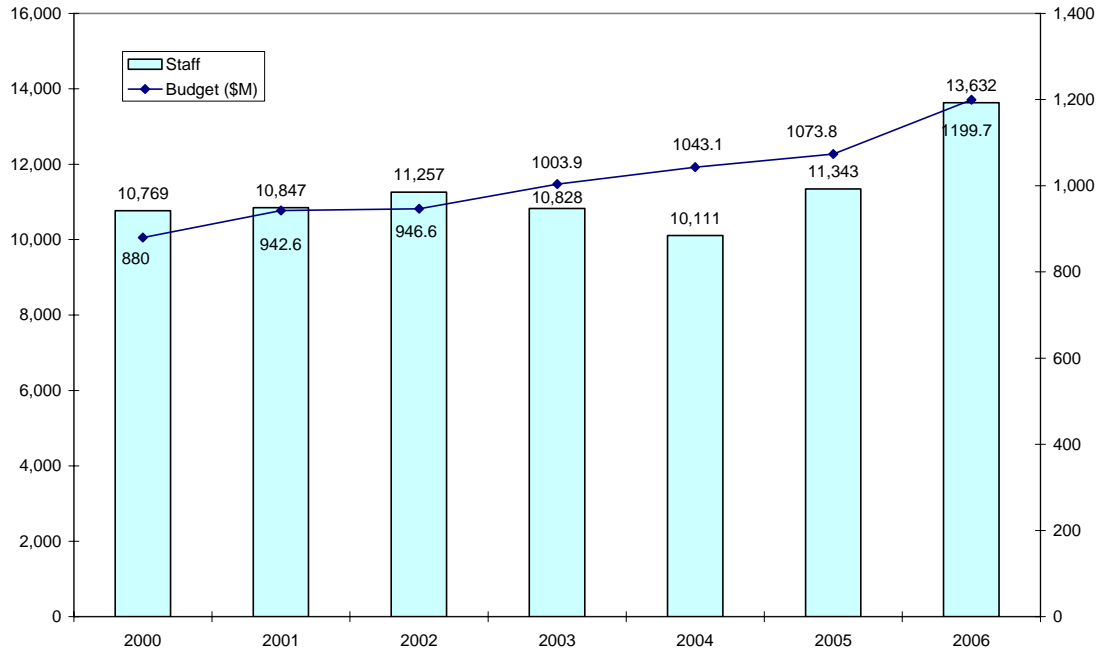
Source: NAIC
Data

Table III.7			
Premiums Written by Non-Domestic Life-Health Insurers			
By State in 2006			
State	Premiums Written by		Non-Domestic Market Share (%)
	Domestic Companies	Non-Domestic Companies	
Alabama	298,066,325	5,233,207,341	94.6
Alaska	-	834,760,555	100.0
Arizona	117,100,491	7,818,979,186	98.5
Arkansas	88,049,707	2,779,417,289	96.9
California	76,601,008	51,420,393,745	99.9
Colorado	328,631,440	8,353,159,748	96.2
Connecticut	8,968,009,457	6,870,054,939	43.4
Delaware	2,041,820,825	19,148,123,831	90.4
Dist. Of Columbia	2,917,207	1,824,003,522	99.8
Florida	117,188,109	29,349,453,410	99.6
Georgia	94,096,665	10,892,022,010	99.1
Hawaii	32,534,630	2,329,902,873	98.6
Idaho	11,343,082	1,804,368,678	99.4
Illinois	1,503,515,928	19,126,798,445	92.7
Indiana	1,463,279,671	8,315,296,615	85.0
Iowa	3,588,079,498	3,709,342,923	50.8
Kansas	271,151,674	6,762,640,085	96.1
Kentucky	40,642,575	4,095,718,603	99.0
Louisiana	189,099,358	6,346,594,741	97.1
Maine	20,841,111	1,819,432,785	98.9
Maryland	82,953,614	13,559,717,706	99.4
Massachusetts	1,256,082,604	11,917,921,901	90.5
Michigan	2,227,779,994	13,784,728,642	86.1
Minnesota	1,855,673,642	8,873,038,300	82.7
Missouri	274,013,875	8,715,275,174	97.0
Missouri	86,937,283	2,521,007,968	96.7
Montana	4,653	941,542,572	100.0
Nebraska	482,479,999	3,146,838,231	86.7
Nevada	-	2,711,936,563	100.0
New Hampshire	3,895,969	2,138,005,891	99.8
New Jersey	3,997,113,346	23,774,433,526	85.6
New Mexico	149,672	1,822,502,902	100.0
New York	28,191,295,409	18,763,361,604	40.0
North Carolina	230,361,030	13,120,640,035	98.3
North Dakota	10,876,876	917,750,343	98.8
Ohio	2,078,124,424	16,121,765,181	88.6
Oklahoma	67,781,186	3,803,658,441	98.2
Oregon	319,696,672	4,195,542,367	92.9
Pennsylvania	451,254,503	21,565,944,160	98.0
Rhode Island	28,844,603	1,707,491,388	98.3
South Carolina	110,067,752	4,969,509,836	97.8
South Dakota	1,130,649	1,105,132,252	99.9
Tennessee	319,837,470	8,215,414,510	96.3
Texas	3,685,963,076	25,560,975,825	87.4
Utah	228,460,797	3,048,828,855	93.0
Vermont	19,631,888	953,128,301	98.0
Virginia	2,451,603,347	10,743,862,258	81.4
Washington	198,817,990	7,992,753,296	97.6
West Virginia	635,249	1,875,780,064	100.0
Wisconsin	789,986,198	8,523,553,424	91.5
Wyoming	-	695,590,887	100.0
Guam	808,328	59,418,880	98.7
Puerto Rico	243,252,558	577,431,857	70.4
Virgin Islands	-	43,791,513	100.0
Total	68,948,483,417	447,301,945,977	86.6
Source: NAIC Data			

**Table IV.1
Insurance Department Resources: 2006**

State	Staff	FY 2008 Budget	Domestic Insurers	Lic. Foreign Insurers
Alabama	151	\$18,240,871	47	1,355
Alaska	57	\$6,571,400	10	738
Arizona	142	\$18,347,600	359	1,562
Arkansas	182	\$10,626,926	70	1,475
California	1,338	\$208,965,000	183	1,202
Colorado	81	\$9,175,673	61	1,420
Connecticut	142	\$22,977,533	105	1,159
Delaware	83	\$25,139,800	139	1,298
Dist. Columbia	98	\$7,964,249	88	1,319
Florida	2,813	\$142,480,100	569	1,597
Georgia	160	\$18,872,191	131	1,494
Hawaii	79	\$9,585,708	185	996
Idaho	76	\$7,319,600	17	1,119
Illinois	264	\$21,597,400	357	1,511
Indiana	97	\$11,281,267	184	1,660
Iowa	101	\$10,825,919	206	1,395
Kansas	143	\$11,300,000	49	1,633
Kentucky	159	\$38,199,600	58	1,512
Louisiana	269	\$30,804,299	131	1,433
Maine	81	\$9,632,874	28	1,043
Maryland	283	\$26,375,509	77	1,446
Massachusetts	127	\$13,426,704	91	1,164
Michigan	130	\$61,896,900	150	1,478
Minnesota	83	\$13,937,320	171	1,320
Mississippi	80	\$8,470,397	46	1,472
Missouri	203	\$14,012,097	219	1,396
Montana	54	\$15,409,941	55	1,383
Nebraska	102	\$9,646,006	100	1,453
Nevada	74	\$15,006,022	132	1,625
New Hampshire	80	\$8,451,379	42	972
New Jersey	363	\$29,975,000	109	1,219
New Mexico	86	\$6,345,600	21	1,447
New York	934	\$300,182,000	576	1,000
North Carolina	395	\$30,171,201	86	1,289
North Dakota	47	\$3,985,490	40	1,401
Ohio	294	\$31,123,567	264	1,507
Oklahoma	145	\$12,159,900	96	1,480
Oregon	90	\$9,064,643	48	1,495
Pennsylvania	414	\$27,604,000	300	1,511
Rhode Island	40	\$6,133,023	34	343
South Carolina	80	\$12,700,000	194	1,196
South Dakota	29	\$1,725,000	45	1,588
Tennessee	148	\$13,017,400	70	1,367
Texas	1,598	\$99,347,742	466	1,540
Utah	82	\$9,404,000	71	1,572
Vermont	61	\$7,058,540	585	1,546
Virginia	209	\$25,931,118	66	1,473
Washington	212	\$23,225,000	56	1,381
West Virginia	404	\$38,301,993	25	1,342
Wisconsin	132	\$15,275,000	384	1,631
Wyoming	27	\$2,252,659	5	1,398
Puerto Rico	117	\$9,628,000	59	343
Total	13,632	\$1,541,601,161		

Figure IV.1
State Insurance Departments Staff & Budget



Source: National Association of Insurance Companies

Figure IV.2
Insurance Regulatory Functions

