

Testing the Insurance Industry's Resolve on State Regulation

FOR DECADES, INSURANCE REGULATORS HAVE UPHELD THE SANCTITY OF STATE REGULATION, depicting any potential loss of state powers to a federal regulatory “gorilla” as an outcome to be avoided at all costs. And in recent years, as the march toward financial services convergence has begun to make some form of federal oversight practically inevitable, concern about the uncertain fate of state regulation has intensified. The proponents of state regulation have insisted that only state regulation can adequately monitor insurers’ financial solvency and protect the interests of insurance buyers. When the feds move in, they maintain, consumers and insurers lose out.

That’s the message that’s been preached over the years by regulators, insurance agents, and most insurance companies. A few of the largest insurance companies, however, increasingly seem to be exploring the idea of operating under a federal charter, as described in a draft proposal unveiled recently by the American Council of Life Insurers. But now the industry’s avowed commitment to state regulation is being put to a crucial test as state insurance departments grapple with the long-awaited implementation of codified Statutory Accounting Principles (SAP) and other pivotal challenges requiring uniformity of approach.

The SAP codification project, launched by the National Association of Insurance Commissioners (NAIC) in the early 1990s, was an effort to develop a uniform means by which the statutory-basis financial condition of insurers could be measured. (See “Laws and Sausages: How Statutory Accounting Was Codified,” Henry W. Siegel, *Contingencies*, September/October 1998.)

Codification, it was hoped, would eliminate the tremendous diversity in accounting practices from state to state, bringing about a harmonization of standards that would benefit the entire industry. After

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years of hard work by the parties involved, the project reached its long-awaited climax in January of this year, when codified SAP finally took effect.

Disturbing Deviations

From the outset, the proponents of codification stressed that one of the primary objectives of the project was the consistent application of uniform SAP guidance in all jurisdictions. It’s disturbing, therefore, considering that the ink on the NAIC-approved codification standards has barely had a chance to dry, that the New York State Legislature already has seen fit to deviate from codification, although it has agreed to revisit the issue this year.

And more deviations are likely, because some states still have not reconciled, or even identified, the differences between their state laws and codified SAP, which means that state laws that are inconsistent from state to state will prevail in such circumstances. This will make the goal of consistent adoption unattainable, at least in the near term.

Modernizing the System

And what about the laudable goals the NAIC developed during the debate on the Gramm-Leach-Bliley Act (GLB)? In their “Statement of Intent on the Future of Insurance Regulation,” issued in March 2000, regulators pledged to modernize the regulatory system by addressing some of the issues that receive the loudest complaints from insurers. That includes:

- Developing standards for state-based, national licensing of agents;
- Methods to get new products to market more quickly on a national basis;
- An approach to "national" regulation that would give one state the primary responsibility for monitoring insurers' financial health, with other states participating in an insurance company examination only when the situation might warrant it.

As with codification, a willingness to accept consistent standards is crucial to achieving these important goals.

Reforming Agent Licensing

Thus, codification is only the first test of whether the states are willing to embrace uniformity. And the stakes could not be higher. Failure to reform agent licensing at the state level, for instance, could jeopardize the NAIC's efforts to negate the

need for the National Association of Registered Agents and Brokers (NARAB), the national clearinghouse for agent licensing established under GLB.

The NAIC's reform initiative is focused on creating a state-based agent-licensing system that exceeds the specifications outlined in GLB. One of the primary vehicles for doing this is the National Producer Licensing Model Act, adopted in January 2000, which seeks to establish uniformity in licensing procedures, simplify the licensing process, eliminate retaliatory fees, and create reciprocity while preserving states' rights.

At its spring meeting in Nashville, the NAIC reported that to date, nine states have enacted laws designed to meet the NARAB reciprocity requirements, and more than 30 states altogether are expected to take action this year. But while the NAIC is pleased with the rate of progress, critics may start asking how

quickly the other states will get on the bandwagon.

Enacting Privacy Standards

Still another huge test is waiting in the wings. The critics of state regulation are watching to see how quickly and in what manner the individual states adopt the uniform privacy standards the NAIC developed in connection with GLB implementation. So far, according to a survey conducted by the NAIC, at least 22 states plan to have the financial privacy provisions of the NAIC model regulation in place and to require compliance by July 1, 2001. Here again, the ultimate outcome has serious implications for the future survival of state regulation.

With respect to the privacy of health information, the survey showed that 37 states plan to not only comply with GLB requirements but to include in their regulations provisions that are more protective of consumers than even GLB requires. Critics, however, believe this is unnecessary and doesn't produce any tangible benefit to consumers.

The opponents of state regulation have always argued that it is a highly inefficient, anticompetitive patchwork system marred by special exemptions, last-minute rules and regulations, and delayed approval or outright rejection of promulgated model laws.

A lack of state cooperation on codification and the monumental challenges related to modernizing state regulation could further inflame these critics, increasing the growing likelihood that the current system will move toward the same kind of dual system of federal and state regulation now seen in the banking industry, with different rules pertaining to federally chartered as opposed to state-chartered insurers.

The system of regulation that has long served the insurance industry is at a crossroads. For those committed to preserving it, the battles now under way present a singular and final opportunity to back up their rhetoric with action. ●