

FEDERAL REGULATION OF INSURANCE IN RETROSPECT AND FOR THE FUTURE

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Prior to the invention of the Gutenberg press in 1452, notations by the monks who recorded the then current events in Latin reflect that the dawn of insurance regulation probably occurred centuries ago.¹ The purpose of insurance regulation was to control competition as well as restrict unauthorized acts. Any analysis of the regulation or oversight of the insurance industry as we know it today should include both the historical and current purposes for providing risk protection, the systems used, and the benefits provided as governed by the laws enacted by the various states and the federal government to assure that the public is protected. The types and amounts of insurance constantly change and the manner in which regulation is provided must likewise change.

During the Seventeenth Century, great interest was shown by the development of contracts which provided not only security but also a reward for those who participated. This was evidenced principally by the Tontine contract. The contract was ultimately prohibited because under its terms the member or members of the insured group under the contract who survived all others within the group received the benefits. This was determined to be contrary to the public interest because it would encourage members of the insured group to eliminate other members of the group in an effort to be the last survivor and receive the reward. This was an early form of life insurance.²

A group of farmers in an area known as Triest, Italy' came together to protect themselves from theft of their property or damage to their farming operations and formed an association which continues today, known as *Generali Securitizone Generali SPA*, one of the largest insurers in the world providing coverages internationally for every type of risk. In countries such as Great Britain, Spain and others, maritime protections were required because their businesses included transportation on the high seas. A new kind of coverage was afforded through a place called Lloyd in London, England, where mariners met, ate and drank when back in port. Again, those in the maritime business provided security for themselves and their patrons so that there would be an assurance that they might be compensated after suffering property losses at sea.³ Lloyd's of London has become a major insurer and reinsurer and continues through syndicates to this day.

Before the 20th Century, there was little regulation of reinsurance. Reinsurers were not fully regulated by all states until the last half of the 20th Century. The rationale was that reinsurers did not deal with the public but only with insurers and needed no oversight for providing financial protection up to a percentage of the risk assumed from insurers. Today, all insurers are regulated. They include associations, mutual companies, stock companies, reciprocal inter-insurance exchanges, health maintenance organizations, preferred provider organizations, risk retention groups, ERISA Plans and others through a distribution system which includes managing general agents, independent agents, third party administrators, purchasing groups, producer groups, etc. The insurance contracts they purvey may be reinsured by a regulated reinsurer.

In the U.S., insurance oversight had its beginnings at the local level and had generally been viewed as a local business providing protection to the citizens of a particular geographical area covering specific perils. In the rural areas, protection of property took the form of insurance against damage due to windstorm, hail and fire. The owners themselves came together as associations or pro forma decree entities (mutual companies) governed by the membership. The geographical areas consisted of one or several counties. There was little or no oversight until those entities expanded their membership and territories. Regulation of the business of insurance has historically been laws enacted by the states interpreted by decisions of both federal and state courts. More recently, enactments by Congress have had a direct impact upon insurance regulation.

As the industry continued to expand, the earlier chief insurance regulators of each state found a need to discuss the manner in which the business of insurance might fairly be regulated between and among the various states while maintaining jealously guarded independent sovereignty. They found it helpful to join together in an association whereby interstate issues might be discussed. The problems of reciprocity and retaliation between and among the

states were significant issues. This association, known as the National Association of Insurance Commissioners (“NAIC”), monitored oversight of a business which had become interstate. Today the regulators of other nations participate through affiliation with the NAIC.

It was not until 1945 when the U.S. Supreme Court agreed to review the *Southeastern Underwriters* case that the commerce clause of the U.S. Constitution was applied to the insurance industry for the first time. The business of insurance declared to be interstate commerce permitted federal jurisdiction over the business of insurance. The Congress then adopted the McCarran-Ferguson Act in 1945 which, in its simplest terms, provided that the business of insurance would be regulated by the states but should they fail to do so, the federal government had the power to regulate insurance.⁴

The state regulators have resisted the establishment of federal regulation. An article written in 1960 reflects the concern that Federal regulation might be imposed either as dual regulation or to replace the system of state regulation. The Gramm-Leach-Bliley Act of 1999 by which the federal government may also regulate non-functional insurance, banking and securities organizations was adopted by Congress in a response.⁵ Sections 20 and 32 as set forth in the Glass-Steagall Act of 1933 were repealed which required separate regulation of banking and commerce.⁶ The following is a reprint of “Federal Regulation and the Insurance Industry” published in 1964 which chronicled the views of a regulator:

Federal Regulation and the Insurance Industry⁷

The insurance industry is ever mindful of the constant scrutiny by the federal government of its activities and practices and in particular the role of the respective states in regulating and supervising the various and complex segments of the industry. Prior to the *Southeastern Underwriters* case, the philosophy of federal regulation was based upon the concept that the insurance business was properly the subject of state regulation only. This philosophy was declared on numerous occasions by the United States Supreme Court, which followed the reasoning that the characteristics of the industry were such as to give it local effect and therefore properly subject to regulation under the police powers of each state. With the reversal of this philosophy, the Supreme Court of the United States, in the *Southeastern Underwriters* case, declared that the business of insurance, by virtue of the fact that it transcends state boundaries, involves commerce between the states, and thereby comes within the terms of the commerce clause of the Constitution of the United States, and thus placing the regulation of the business of insurance under the supervision of the federal government.

Pursuant to the decree of the Supreme Court, the Congress of the United States enacted the McCarran-Ferguson Act, commonly known as Public Law 15, whereby the principle of federal regulation was established, providing that in those areas where the business of insurance is not properly regulated by the states, it shall be within the jurisdiction of the federal government to establish proper regulation.

Generally, the insurance industry has been content with the type and scope of regulation of the respective states. However, Public Law 15 has led many of us who are close to the insurance industry to examine the respective areas of the insurance industry which are not being regulated by the various states. This has resulted in the enactment of numerous pieces of legislation in an effort to close gaps which have arisen as the result of this constant changing and dynamic industry. It is true that many of the practices which existed years ago have been modified, and as the result of innovations new forms of insurance and new types of coverage have resulted, many of which were not contemplated by existing laws. The additional bills that have been introduced and enacted into law have been designed to properly cover the new concepts of the industry so it could not be said that these areas are not regulated by the respective states.

In addition to the laws and the regulations of the insurance departments, there exists another area which is equally important. This is the area of general effectiveness and strength of insurance departments. It is certainly true that the insurance departments of the various states have done a tremendous job in regulating one of the fastest moving and dynamic industries in the world. However, we also recognize that in order to

continue the effectiveness of state regulation, we must be assured of competent personnel who are trained and able to provide solutions for the many problems which arise in the industry.

We certainly cannot expect those persons who are newly appointed to positions in the insurance departments to be fully conversant and knowledgeable of the various segments of the insurance industry and their problems. Because of this, it is felt that it is incumbent upon us to assume the duty of training the regulatory officials by providing information and maintaining a liaison whereby confidence may be established between the regulatory body and the industry. This would in turn give us an opportunity to understand the problems of regulation, the goals of the insurance department and the need for protecting the public. For these are the objectives which the insurance department seeks to achieve in fulfilling its role of regulation.

During the past ten years, the insurance industry in Missouri has grown to the point where competition has become severe and public interest more keen. It is therefore essential that the insurance department of the State of Missouri be strengthened in every division. At the present time, there is a need for additional competent examiners who can properly examine insurance companies at closer intervals so that the financial condition of the companies domiciled in Missouri can be detected before it is too late. A further reason for the need of additional examiners is to assist the Missouri companies which are seeking admission to other states. We have found that because a company has not had an examination within one year prior to making application to another state they are turned down. In many cases the company has been due and often times overdue for an examination, but the insurance department is not able to provide examiners because of lack of personnel. Another area which needs strengthening is the area of agents' licensing and control. At the present time there are approximately 100,000 agents' licenses issued by the insurance department. There is no statutory authority for determining the competence of prospective agents, and, furthermore, there is a limited staff in the insurance department to handle the problems arising in connection with agents licensed in Missouri. We could continue to make suggestions with regard to each division of the insurance department; however, I think it sufficient to say that each should be examined for the purpose of determining the work load, the service required, and then study personnel requirements to meet the needs of the department. It is my opinion that the number of personnel presently assigned is not adequate to handle the tremendous work load.

Therefore, when we think of federal regulation we must consider the whole gamut of the insurance industry, the service provided by the industry, as well as the service of the insurance department in assisting the industry and controlling its activities. I am sure that many of us have given thought to this problem, and because of its importance steps will be taken in order to avoid dual regulation.

The NAIC, now a separate entity created by state regulators, has developed a system for state regulation which has been characterized by some as *National Regulation*. Gramm-Leach-Bliley is an extension of *Federal Regulation*. The enforcement of state insurance law constitutes *State Regulation*. Federal and state judicial systems which interpret legislative enactments provide a form of *Common Law Regulation*. Insurance regulation in any form today includes every aspect of the insurance business. Further federal legislation, such as the recently enacted USA Patriot Act as well as the Sarbanes-Oxley Act, will increasingly become a part of insurance oversight whether it be characterized as *state, national or federal* regulation.

The scope of regulation has also been expanded to include other financial services. Since 1972 when the Model Insurance Holding Company Act was developed by working groups at the NAIC, insurance companies as well as any transactions entered into with their affiliates became regulated. Many affiliates of insurers are in other businesses contemplated by the Insurance Holding Company Act, including subsidiaries engaged in investing, marketing, safety engineering, actuarial, loss prevention, data processing, accounting, claims, appraisal and collection services so long as they related to the business of insurance. These services have been affected by advances in technology, an expanding population, limitless means of communication, medical advancements and other services which have elevated public scrutiny as well as an intensely sensitive legal and judicial system. National and international issues must also be considered with the proliferation of off-shore captives. Many of the

characteristics which have been considered local are now affected by the changes brought about by legislation promulgated by the states and the federal government.

In the future, the states may regulate insurance and financial services as required by state insurance laws in a manner coordinated by the NAIC when not pre-empted by an act of Congress or managed by an agency of the federal government.

Endnotes

1. "Latin Monastic Law," by Bernard Justinian printed in Paris, 1480.
2. **Tontine.** In French law. A species of association or partnership formed among persons who are in receipt of perpetual or life annuities, with the agreement that the shares or annuities of those who die shall accrue to the survivors. This plan is said to be thus named from Tonti, an Italian, who invented it in the seventeenth century. The principle is used in some forms of life insurance. *Merl.Repert; Cahn v. Northwestern Mut. Life Ins. Co.*, 208 Ill. App. 317, 322; *Gourley v. Northwestern Nat. Life Ins. Co.*, 94 Okl. 46, 220 P. 645, 646.

Under the "Tontine" plan of insurance, no accumulation or earnings are credited to the policy unless it remains in force for the Tontine period of a specified number of years. Thus those who survive the period and keep their policies in force share in the accumulated funds and those who die or permit their policies to lapse during the period do not; neither do their beneficiaries participate in such accumulation. *Commercial Travelers' Ins. Co. v. Carlson*, 104 Utah 41, 137 P.2d 656, 660.

Black's Law Dictionary, Fourth Edition (1951).

3. **Marine insurance.** A contract whereby, for a consideration stipulated to be paid by one interested in a ship, freight, or cargo, subject to the risks of marine navigation, another undertakes to indemnify him against some or all of those risks during a certain period or voyage. *1 Phil. Ins. 1.* A contract whereby one party, for a stipulated premium, undertakes to indemnify the other against certain perils or sea-risks to which his ship, freight, and cargo, or some of them, may be exposed during a certain voyage, or a fixed period of time. An insurance against risks connected with navigation, to which a ship, cargo, freightage, profits, or other insurable interest in movable property may be exposed during a certain voyage or a fixed period of time. Civ. Code Cal. § 2655.

Black's Law Dictionary, Fourth Edition (1951).

4. McCarran-Ferguson Act, 1945. 15 U.S.C. 1011 *et seq.*
5. Gramm-Leach-Bliley Act, 1999, 106th Congress.
6. Glass-Steagall Act, 1933 (12 U.S.C. 377) (12 U.S.C. 78).
7. Article published in 1964 by the *Missouri Insurance Journal* written in 1960 by the then General Counsel of the Missouri Division of Insurance, Nicholas M. Monaco.