

1991
26 A

**California Insurance Law: The Impact
of Federal Policy Initiatives on State Law Making**

by
Jason Schlimgen
Spring 1991

AUGUST 12, 1991

Business Insurance

Reporting weekly for corporate risk, employee benefit and financial executives / \$2.00 a copy; \$80 a year

© Entire contents copyright 1991 by
Crian Communications Inc. All rights reserved

Update

Bush administration to unveil tort reform recommendations

WASHINGTON—The Bush administration this week will unveil a series of recommendations, including new limits on punitive damage awards, to reduce tort system costs, an administration official said.

Included in the package is a recommendation that would limit punitive damage awards in personal injury suits to the amount of compensatory damages awarded.

Another recommendation proposes

Continued on next page

Oversight proposals hit NAIC head blasts Dingell, Metzenbaum proposals

By DOUGLAS MCLEOD

NEW YORK—Federal insurance regulatory proposals unveiled in Congress this month are drawing scathing criticism from the National Assn. of Insurance Commissioners and measured objections from several industry groups.

NAIC President James E. Long last week sharply criticized proposals by Sen. Howard M. Metzenbaum, D-Ohio, and Rep. John D. Dingell, D-Mich., that provide for federal oversight of insurer solvency regulation.

Charging that botched federal regulation contributed to crises in the savings and loan and banking industries, Mr. Long said that "any prudent observer of this circus would conclude that federal invol-

cate the dual federal-state regulatory structure that generated the regulatory fiascos in the thrift and bank systems over the last decade," Mr. Long, the North Carolina insurance commissioner, charged in a statement.

Insurance industry and risk management representatives, meanwhile, offered mixed to moderately critical views of the bill introduced by Sen. Metzenbaum and the outline of legislation released by Rep. Dingell. The proposals are similar in several respects.

Insurance industry trade groups complained that both proposals could create duplicate federal/state regulation, restrict insurance market capacity and hamper the use of captive insurers.

The Metzenbaum bill, for example, would create a federally administered guaranty fund. That idea may be tough to sell in Congress in the wake of huge federally insured bank and thrift losses, observers say.

Rep. Dingell, chairman of the House Energy and Commerce Committee and its Oversight and Investigations Subcommittee, also may have clearer jurisdiction over insurance regulation than Sen. Metzenbaum does in the Senate, observers say. Sen. Metzenbaum is chairman of the Senate Judiciary's Antitrust, Monopolies and Business Rights Subcommittee.

"It's pretty clear that Dingell is still driving this train," said Andrew Wright, senior counsel to the

Update

Federal tort reform proposal

Continued from previous page
on a limited experimental basis—forcing the losing party to pay the legal costs of the winning party.

The package also proposes certain incentives for disputing parties to use alternative dispute mechanisms.

The entire package of recommendations will be presented by Vice President Dan Quayle at the American Bar Assn. meeting in Atlanta. The vice president chairs the President's Council on Competitiveness, which drafted the recommendations.

World Life & Health in runoff

HARRISBURG, Pa.—World Life & Health Insurance Co. of Pennsylvania is now being run off after a state court late last month granted the state insurance department's April 1 liquidation order.

The King of Prussia, Pa.-based insurer, which was suspended by the department from writing new business on June 6, was ordered into liquidation by a Pennsylvania Commonwealth Court on July 30. When it was suspended, World Life was insolvent by about \$4.5 million, a department spokesman said.

The department moved to shut down World Life & Health after disallowing \$6.2 million in reinsurance from offshore companies lined up by World Re Inc. of Atlanta, an intermediary that U.S. Senate investigators say is linked to insurance consultant Alan Teale (BI, April 29).

The liquidation order does not cancel any group life or health policies or annuities. The Pennsylvania Life & Health Guaranty Assn. will pay all policyholder claims. Policyholders wishing to surrender their policies are eligible to receive up to \$100,000. All life and health claims will be capped at \$300,000.

World Life & Health wrote \$24.2 million in group accident and health premiums and \$470,000 in group life premiums in 1990, the department says.

Ex-Fireman's Fund chief sues

NOVATO, Calif.—Fund American Cos. Inc. will ask a federal judge on Oct. 3 to dismiss a suit by a former chairman of Fireman's Fund Insurance Co. alleging that being kept in the dark about the impending buyout of Fireman's Fund in 1990 cost him more than \$5 million.

—*Mark stepped down at the end of 1989 but agreed*

Accreditation standards for HMOs winning praise

BY CHRISTINE WOOLSEY

WASHINGTON—Employers and managed care companies are embracing the expanded quality review standards recently released by the National Committee for Quality Assurance.

The NCQA, an independent, non-profit organization that reviews and accredits health maintenance organizations, has created new guidelines on health service utilization management, provider credentialing, members' rights and preventive health services.

The Washington, D.C.-based organization—which charges HMOs to be reviewed—also has clarified existing standards on quality assurance and

medical records.

Managed care companies that meet the review requirements receive the NCQA's accreditation—which some observers liken to the "Good Housekeeping seal of approval."

"Accreditation is necessary because outside customers want an assurance that HMOs are delivering quality health care, not just discount health care," said NCQA Executive

being carried out."

As part of its review of HMOs, NCQA examiners now will assess the organization's:

- Utilization management. The organization must have a written utilization management program description that includes, at a minimum, procedures used in evaluating medical necessity, criteria used to judge the proper course of treatment, infor-

McIntyre Maleck Bucke to be

Kathryn J. McIntyre, associate editor of *Business Insurance*, will be publisher and editorial director, effective

—*replaced by*
The McIntyre group would succeed

Regulation

Continued from page 1

mittee last week approved a banking reform bill that calls for the creation of a presidential commission to examine insurance issues.

The presidential commission, proposed by Sen. Christopher J. Dodd, D-Conn., would report to Congress by January 1993 on topics like insurer solvency, the effectiveness of state guaranty funds, insurance industry antitrust issues and health insurance for the uninsured (BI, June 17).

Industry observers are uncertain what impact such a commission would have on efforts to enact federal insurance solvency legislation.

Some say these efforts could be slowed if lawmakers decide to wait for the commission's findings before acting on a solvency regulation bill. Others, however, expressed doubts that a presidential commission would stall efforts already under way in the House and Senate, and particularly those by Rep. Dingell.

"I think Dingell is pretty well committed to doing something," said Robert B. Shapiro, a Washington lawyer familiar with the legislative action.

"My impression is he's intent on moving," added Peter Lefkin, VP-government and industry affairs with Fireman's Fund Insurance Co. in Washington, D.C.

Rep. Dingell's legislative outline, released Aug. 1 by the Oversight and Investigations Subcommittee, follows a shorter discussion outline circulated informally earlier this year (BI, March 25).

The latest outline calls for:

- Creation of a Federal Insurer Solvency Corp., funded by insurance company fees and assessments, to develop and enforce solvency standards for multistate property/casualty and life/health insurers. The FISC would also oversee regulation of risk retention groups and multiple employer welfare arrangements.

The federal agency would not directly regulate multistate insurers, but would issue certificates of approval to state-licensed insurers and oversee state regulatory efforts. However, it would directly regulate professional reinsurers.

The FISC—whose five-member board of directors would be appointed by the president subject to confirmation by the Senate—would have authority to issue orders restricting insurance activities of specific companies and individuals and also would have special examination powers.

- Establishment by the FISC of minimum solvency standards for insurers in interstate or foreign commerce.

Standards would include minimum capital and surplus requirements; limits on the use of reinsurance; standards for investments, reserves and asset valuation; requirements for independent audits and actuarial certification of loss reserves; national standards for state guaranty funds; procedures for determining when an insurer is insolvent or impaired; and, national liquidation procedures for insolvent companies.

• Accreditation by the FISC of state insurance departments or industry self-regulatory bodies that meet the federal minimum solvency standards.

The FISC would have the authority "to recognize any regulatory organization that it determines will successfully implement the corporation's solvency standards."

The FISC also could suspend or revoke accreditation of any body that does not continue to meet the standards. Any insurer licensed in a state whose accreditation is revoked would have to withdraw from interstate commerce or re-domesticate to an accredited state.

• FISC approval of coverage placed with any alien insurer or reinsurer.

Insurance buyers would be required to provide the FISC with information about the proposed coverage and show that the insurer or reinsurer has had at least three years of successful operation; agreed to submit to the jurisdiction of U.S. courts; and established a trust fund in the U.S. under guidelines established by the FISC.

The FISC would have the authority to reject any alien insurer or reinsurance arrangement that does not meet its standards.

• Establishment of federal civil and criminal penalties for insurance fraud, which would include filing false financial statements, self-dealing, theft and reckless management.

• Investigation by the FISC of multistate insurer insolvencies to update and improve solvency standards, make referrals to regulatory and law enforcement officials, and maintain a data base of information on individuals and companies involved in the insolvencies.

The FISC would also be authorized to research and report to Congress on any issue affecting insurer solvency.

Sen. Metzenbaum's bill, the Insurance Protection Act of 1991, in-

troduced Aug. 2, is in many ways similar to the Dingell outline.

Unlike the Dingell proposal, though, the Metzenbaum bill would create a National Insurance Guaranty Corp., a national guaranty fund superseding state funds and covering claims against all insolvent interstate property/casualty and life/health insurers.

The NIGC would be pre-funded with assessments against insurers and would not be supported with any federal funds or guarantees. Industry groups said they were still studying the proposals last week, but initial reactions ranged from severely critical to supportive.

The NAIC's Mr. Long voiced several general objections, noting that the history of dual federal/state regulation in other areas is "replete" with regulatory breakdowns.

Federal involvement in insurance matters has often caused more problems than it has solved, Mr. Long added, pointing to regulatory problems caused by the federal Risk Retention Act and by MEWAs formed under the Employee Retirement Income Security Act of 1974.

Mr. Long also said the proposals could jeopardize states' ability to levy premium taxes—a major source of state revenue—and charged that they would place regulation in the hands of government officials with "virtually no experience" in insurance.

"Both proposals raise the very real specter of regulation by federal amateurs," Mr. Long charged. Insurance industry and risk management groups' initial reactions to the proposals were mixed.

Tough federal solvency standards and other provisions of the proposals could hamper corporations' use of captive insurers, observed Paul Brown, director of governmental affairs for the Risk & Insurance Management Society Inc. in New York.

He suggested that separate rules within a federal regulatory scheme should apply to captives.

Mr. Brown and others expressed support, however, for federal regulation of reinsurers.

"To the extent that it will, in effect, make a one-stop licensing procedure for reinsurers, I think we would support that," Mr. Brown said.

Several observers contended that the proposals would create another layer of oversight without actually improving solvency regulation.

"It's no surprise" that Sen. Metzenbaum and Rep. Dingell "would

add another layer of federal regulation instead of trying to fine-tune the existing system of state insurance regulation," said Lowell R. Beck, president of the National Assn. of Independent Insurers of Des Plaines, Ill.

Mr. Beck called instead for state legislatures to adopt the solvency standards that the NAIC has developed as part of its solvency policing agenda.

"We were struck by how similar (the Dingell) proposal is to what the NAIC already has in place" through its solvency policing agenda, observed Greg Heidrich, VP-research with the Alliance of American Insurers in Schaumburg, Ill. "In a sense, it's the sincerest form of flattery."

"We do feel strongly that the state system is capable of doing an excellent job of regulating solvency," Mr. Heidrich added.

Mr. Shapiro noted that many large insolvencies have occurred not because state regulators lacked the authority to forestall them, but because regulators didn't act on the authority they had.

"What we need is someone to make sure regulators use the tools that are available to them," Mr. Shapiro said, expressing doubts that the federal proposals would accomplish this.

"I don't think we need the federal government to tell us what standards (regulators) ought to hold insurers to," he said.

Mr. Shapiro also worried that the Dingell proposal's restrictions on alien insurance and reinsurance could "kill the market," severely limiting capacity for U.S. risks.

"Offshore companies are not going to want to go through that," he said of the demands FISC would put on alien insurance and reinsurance placements.

"If the market hardens and this proposal is in place, I really do see a capacity problem," he predicted.

While Mr. Shapiro said he was expressing his own opinions, he represents a coalition of brokers, insurers and policyholders now being formed to address regulatory issues.

The coalition—which so far includes Marsh & McLennan Cos. Inc., Alexander & Alexander Services Inc., Sedgwick James Inc., American International Group Inc., and Dow Chemical Co.—favors a "two-tier" regulatory system in which commercial insurance would be regulated for solvency by the federal government but would be free of rate and form regulation.

Personal lines insurance would still be subject to state regulation and to rate and form rules.

still be subject to state regulation and to rate and form rules.

"The most positive thing" about the Dingell proposal is that it's still a discussion draft," AIA's Mr. Wright said of the Dingell proposal, which he said the AIA is reviewing before submitting comments to the House subcommittee.

Fireman's Fund's Mr. Lefkin, meanwhile, expressed support for the Dingell proposal. "It's a good proposal. We like it."

While conceding that the Dingell proposal presents the risk of duplicating regulation, Mr. Lefkin pointed out that with the current state-by-state system, "we are doing 51 sets of regulations right now."

Having a federal agency involved in solvency regulation could also "sensitize" the federal government to problems affecting the insurance industry, including tort reform and liabilities arising from the federal Superfund law.

Meanwhile, observers agree that the Metzenbaum bill could face problems in the Senate because of its national guaranty fund provision, even though no federal money would be used to back up the fund.

"I don't think a national guaranty fund has a snowball's chance," Mr. Shapiro said, explaining the huge losses hitting the Federal Savings & Loan Insurance Corp. and the Federal Deposit Insurance Corp. will undermine any guaranty fund proposal.

Even if insurers are responsible for financing the fund, observers may worry that proposals would look to cap federal government for payment. If that fell short, he observed.

"Given those problems, it's unlikely that the federal government will want to get involved, even to the extent of administering something funded by the insurance industry," Mr. Shapiro said.

Observers also put Rep. Dingell's proposal on a faster track because he heads the House committee on subcommittee with jurisdiction over insurance regulatory matters.

Sen. Metzenbaum's bill is likely to be referred to the Senate Commerce, Science and Transportation Committee, where the Consumer Subcommittee headed by Sen. Richard H. Bryan, D-Nev., has already held insurance hearings and may be developing a regulatory proposal of its own, observers say.

No one is underestimating Sen. Metzenbaum, however. He pushed for seven years, ultimately successfully, to restrict employers' ability to recapture surplus assets from terminated defined benefit pension plans.

Executive Life

Continued from page 1
 lien against the insurer by the Internal Revenue Service.

And, the Insurance Department will entertain any better offers until the sale and rehabilitation plan receives final court approval, Mr. Garamendi said.

Concerned about its soured junk bond portfolio, regulators seized Executive Life on April 11 and placed it into court-supervised conservatorship (BI, April 15).

At the time it was seized, Executive Life had 208,000 life insurance policyholders and 164,000 annuity holders in 50 states.

The tentative agreement to sell Executive Life does not include its sister company, Executive Life Insurance Co. of New York, or its parent, First Executive Corp. of Los Angeles.

Mr. Garamendi said the tentative deal, which regulators had negotiated over 90 days, meets the three goals he set at the time Executive Life was seized. The proposal ensures the maximum financial value for policyholders and GIC contract holders; it initiates a revitalization strategy to make the company a viable and ongoing concern; and it avoids a "fire sale" liquidation "that would take much of the savings out of the pockets of policyholders and put it into the hands of competing battalions of lawyers."

"We have structured this agreement to give policyholders the greatest value as well as the highest degree of certainty as to their future of their investments," Mr. Garamendi said.

"Our experts have spent thousands of hours poring over the records of Executive Life to make sure they will get the best deal possible," he said. "We think it is unique in the annals of insurance conservation."

Under the agreement, the assets and liabilities of Los Angeles-based Executive Life will be split among three entities, the commissioner explained.

Althus Finance, a division of state-controlled bank Credit Lyonnais in Paris, would purchase \$2.7 billion in junk bonds now held by the defunct insurer. That portfolio would be controlled by a new investment management company.

Althus has tentatively agreed to buy the junk bond portfolio even if the remainder of the deal collapses, Mr. Garamendi said.

In addition, Paris-based life insurer Mutuelle Assurance Artisanale de France would pay \$300 million to finance a new, yet-unnamed California-based stock life insurance company, which would be managed by the investor group. This company,

If the sale is approved, group and individual annuity holders would receive payments equating approximately 81% of the value of their policies and 100% of death benefits.

Policyholders—including group annuity holders—may receive 100% of what they were promised if guaranty funds agree to make payments, Mr. Garamendi said.

The transaction would be structured so that Executive Life is technically liquidated. The California Insurance Department is negotiating with guaranty funds in 38 states to provide funding to make Executive Life policyholders whole, Mr. Garamendi said.

"Now that we have an agreement that gives policyholders a fixed percentage of their contract values, I urge these guaranty funds around the nation to work quickly with us to provide that additional funding," he said.

As an incentive for policyholders to remain with the new insurance company, they also may receive a portion of increased penalties imposed on policy surrenders, according to Mr. Garamendi.

Pension plans that purchased Executive Life GICs will not be able to cash out for five years. At that time, they would have the option to cash out at the contracts' face value, according to Insurance Department attorney Carl Rubinstein of Rubinstein & Perry in San Francisco.

Meanwhile, full death benefits will be paid on behalf of pension plan participants who die, and pension plan participants who retire will be given single-premium annuities insured by the newly created insurer, Mr. Rubinstein said.

Interest earned on GICs during the moratorium will be calculated using a formula tied to five-year U.S. Treasury bond rates, less 100 basis points. The minimum rate would be 4%.

Mr. Garamendi stressed that "there are three critical areas" that must be handled before the court can be expected to confirm the agreement.

"Our biggest concern is the \$643 million lien by the Internal Revenue Service for taxes, interest and penalties that it believes is due from the company for three tax years in the early 1980s," he said.

The IRS, in a letter sent in April to Executive Life's headquarters, demanded "immediate payment" of \$249 million in back taxes and \$334 million in interest and penalties (BI, April 29).

"We are continuing our discussions with the IRS, the Department of Treasury and other relevant officials in Washington regarding this tax liability. Now that we have a deal in hand, it is more important than ever to reach a satisfactory conclusion."

Mr. Garamendi estimated that annuity payments would be reduced 8 cents on the dollar if the new insurer must pay the tax lien. Payments would thus be cut from a proposed 81 cents on the dollar to 73 cents, only slightly more than the 70% payments that annuitants have been receiving under the conservation order.

The tax treatment of the transaction also could reduce ultimate payments to annuity contract holders, according to Mr. Garamendi.

"The tax code does not appear to contemplate the kind of rehabilitation plan that we have agreed to. The way in which the IRS may treat this agreement could very well affect its chances for success," he said.

A second issue that could jeopardize the agreement is a lawsuit brought by several bond-issuing municipal entities that purchased GICs from Executive Life to guarantee payments, according to Mr. Garamendi.

"These multi-GICs are not covered by the provisions of the state guaranty fund and we do not recognize them as Class 5 claims under the insurance code," he said.

Thus far, only claims from so-called Class 5 policyholders—like annuitants and life insurance policyholders—have been honored under the conservation order.

"While my original request for (purchase) proposals contemplated that multi-GICs should receive 30% of the value received by regular policyholders, today's agreement does not include such a provision," Mr. Garamendi pointed out.

Because negotiations between multi-GIC holders and the Insurance Department have broken down, "we'll see them in court," he said. A Sept. 30 date has been set to determine whether multi-GICs are a form of insurance.

Another factor that could affect the ultimate fate of the rehabilitation plan could be the U.S. economy.

"The investment group and Althus are content with the prospect of finalizing this agreement in the current economic climate. However, should there be a drastic decline in the stock and bond markets, the agreement

would be seriously jeopardized," said Mr. Garamendi.

Although the Insurance Department forged this purchase agreement with the French investment group, it also is encouraging other offers for the company, according to Mr. Garamendi.

"While we believe this to be an excellent deal for policyholders, the only way to truly know that it is the best one possible is to subject it to the rigors of the competitive marketplace," he said.

"The French investment group has cleared the bar with an impressive opening height. I now encourage others to get into the competition and outstep their performance."

Employers that purchased GICs from Executive Life generally are pleased with the purchase agreement.

"I think the members of the Group Annuity Participant Protection Assn. ought to be very pleased that we are included in this rehabilitation plan because that has been a question to this point," said Robert R. Evans, chairman of GAPPA's steering committee and assistant treasurer of Xerox Corp. in Stamford, Conn.

Members of the group hold more than \$540 million invested in GICs issued by Executive Life.

Before the announcement of the agreement, it was unclear whether GIC holders were considered policyholders eligible for payment under the conservatorship order.

"It sounds encouraging to us," said a spokesman for Maxxam Inc., the parent company of Scotia, California-based Pacific Lumber Co., which has been paying the difference between what Executive Life has been paying retiree with annuities and what they were promised.

"We're encouraged by the 81% figure and the thought that the guaranty funds may provide 100%," he said.

One area that will not be affected by the sale: suits charging that employers violated the Employee Retirement Income Security Act of 1974 by purchasing Executive Life annuities to pay pension benefits.

The Labor Department does not plan to drop litigation it has filed against Maxxam and MagneTek Inc. of Los Angeles, a spokeswoman confirmed.

Those suits charge that the companies failed to act in the best interests of plan participants by selecting Executive Life as the annuity

provider. Indeed, consultant Coorning & Co. warned Maxxam that the insurer's junk bond holdings were "highly controversial," the report asserted (BI, June 17).

Employers, as pension plan fiduciaries, have a responsibility to buy the safest annuities, said Assistant Labor Secretary David Ball. "We are concerned that plan fiduciaries live up to that responsibility," Mr. Ball said. "The fiduciary liability will remain."

Employees that have sued employers that purchased Executive Life annuities also plan to continue to their efforts, their attorneys say.

"If the commissioner can put together this deal, it's great for the policyholders," said Lucia Savage, an attorney with Sigman & Lewis in San Francisco, who is representing Pacific Lumber retirees in their suit against Maxxam and Executive Life (BI, April 22).

However, "the lawsuit pre-exists Executive Life's downfall," Ms. Savage said.

Another lawyer, who represents employees that are suing MagneTek, agreed.

"Even if the policyholders are made whole, it doesn't obviate the necessity of a lawsuit," said Charles Both of the Washington, D.C., firm if Yablonski, Both & Elderman. "It was still a prohibited transaction, and the lawsuit was filed before Executive Life was placed into conservatorship."

ERISA experts agree that the ERISA litigation should be continued.

"In the absolute, the Labor Department should review the methodology used by plan trustees to select investments," said Daniel G. Brown, an attorney with Williams, Kelly, Romanak, Polverari & Shelton in Redwood City, Calif.

"These are two separate issues," said Michael S. Gordon, a Washington, D.C., attorney who helped draft ERISA.

"Whether Executive Life is bailed out has nothing to do with whether the plan trustees violated their fiduciary responsibility by selecting Executive Life," he said.

Mr. Gordon also pointed out that the suits may trigger subrogation by guaranty funds against employees that recover from their employers.

Mr. Gordon pointed out. "The question is, 'Who's going to bear the risk of this loss?' The plan trustees or the insurance industry?" he asked.

Besides MAF and Althus, other investors involved in the transaction are:

- Pallas, a Paris-based holding company with investments in various financial services operations

Met Life to manage Mutual Benefit

NEWARK, N.J.—Metropolitan Life Insurance Co. will manage Mutual Benefit Life Insurance Co. cases.

MetLife Insurance Co. has announced that it will manage Mutual Benefit Life Insurance Co. cases.

Business Insurance®

Reporting weekly for corporate risk, employee benefit and financial executives / \$2.00 a copy; \$60 a year

© Ennis content copyright 1991 by Ennis Communications Inc. All rights reserved

Update

Feds sue 2 firms that bought annuities from Executive Life

WASHINGTON—The Labor Department is charging that two employers violated the Employee Retirement Income Security Act by purchasing annuities from Executive Life Insurance Co. of California to pay benefits promised to pension plan participants.

In one case, the department is suing Houston-based Maaxam Inc. and subsidiary Pacific Lumber Co. of Scotia, Calif. In 1986, Maaxam terminated the Pacific Lumber pension plan, bought

Continued on next page

Action expected soon on McCarran proposal House panel considers Brooks bill

By JERRY GEISEL
and ADRIENNE LOCKE

WASHINGTON—Legislation introduced in the House to overhaul the insurance industry's antitrust exemption under the McCarran-Ferguson Act is back on the fast track, with subcommittee and committee votes expected soon.

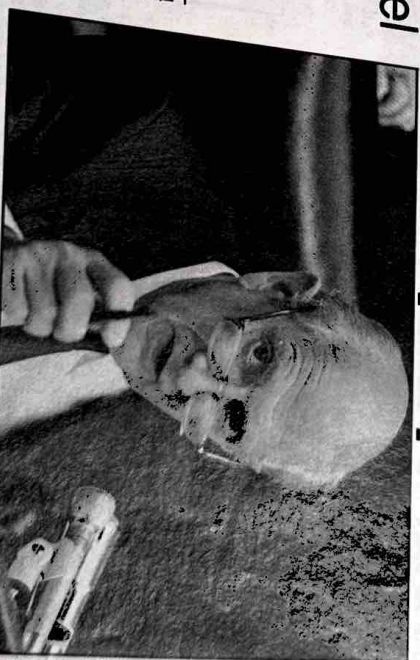
Industry observers say last week's hearing on the legislation, H.R. 9—introduced by Judiciary Committee Chairman Jack Brooks, D-Texas—is a sign that action is near, first by the Economic and Commercial Law Subcommittee and then the Judiciary Committee.

"The hearing is a signal for action," said Tom O'Day, associate up of the Alliance of American Insurers in Washington, D.C.

The hearing is a "precursor" to a vote, agreed Barbara Haugen, director of federal affairs with the National Assn. of Insurance Brokers in Washington, D.C.

Indeed, Rep. Brooks suggested that he intends now to move quickly on his proposal, which the insurance industry strongly opposes as damaging both to insurers and policyholders.

"We will think about what we heard (at the hearing) but I don't know how long we will think about it," Rep. Brooks said.



AP/Wide World Photo

Rep. Jack Brooks says 'we will think about what we heard (at the hearing) but I don't know how long we will think about it.'

It isn't known how receptive Rep. Brooks will be to changes to his legislation when it comes up for a vote.

In a clear reference to a McCarran-Ferguson alternative proposed by the American Insurance Assn., Rep. Brooks described that proposal as a "constructive effort." However, he said the proposal "falls short of all that is needed." An AIA spokeswoman said the

trade group will continue to discuss McCarran-Ferguson changes with Rep. Brooks.

"We're still talking to Rep. Brooks. The door is not closed," she said after the hearing.

Under the AIA proposal, most insurance industry practices would be fully subject to federal antitrust laws with the exception of four safe harbors for essential business

Continued on page 38

Labor Department sues 2 firms

Continued from previous page
annuities from Executive Life and recovered about \$62 million in surplus assets.

The department's suit charges that Maaxam, Pacific Lumber and plan trustees failed to act in the best interests of plan participants by selecting Executive Life as the annuity provider. Executive Life was selected despite warnings from consultant Conning & Co. that Executive Life's junk bond holdings were "highly controversial."

The other suit involves Los Angeles-based Magnetek Inc., which used more than \$23 million in pension plan assets to purchase annuities from Executive Life on behalf of plan participants.

Both suits seek reimbursement for any losses to participants and ask that the employers buy new annuities to guarantee benefit payments. "We want to send a clear signal that employers must honor their commitments" by choosing strong insurers, said Assistant Secretary of Labor David Ball.

Maaxam said the suit is without merit. It noted that Executive Life had the highest ratings from A.M. Best Co. and Standard & Poor's Corp. when the annuities were purchased. Magnetek declined to comment.

Both firms say they currently are ensuring that retirees receive their full promised benefits. Under Executive Life's conservation order, the insurer is paying annuitants only 70% of promised benefits. Maaxam said making up this difference is costing the firm more than \$48,000 a month, while Magnetek pegged its costs at \$68,000 a month.

Florida work comp law stands

TALLAHASSEE, Fla.—Sweeping state workers compensation reforms that reduce benefits and roll back rates 25% are constitutional and will remain in effect, the Florida Supreme Court has ruled.

In a suit brought by the Florida AFL-CIO, a lower court had ruled that the law containing the reforms was unconstitutional because it dealt with more than one subject and excessively reduced workers comp benefits (BI, Nov. 12, 1990, July 2, 1990). The law dealt with international trade by Florida companies as well as workers comp.

However, the Florida Legislature in January passed the workers comp and international trade provisions as two separate laws.

The state Supreme Court also ruled that the law provides sufficient benefits and is a reasonable alternative to tort litigation.

Florida AFL-CIO President Dan Miller asserted the law helps only employers, saying benefits will be cut 30% across the board.

Bank insurance law upheld

NEW YORK—A federal appeals court ruling allows subsidiaries of state-chartered banks to sell and underwrite insurance nationwide if the state in which they are based allows such sales.

The ruling opens the door for large bank holding companies to compete directly with agents and insurers.

In its unanimous June 10 decision, the 2nd U.S. Circuit Court of Appeals overturned a Federal Reserve Board decision that effectively nullified a Delaware law. The Fed had ruled that the Delaware law ran afoul of federal banking law by requiring banks to set up operational and financial "firewalls" between their banking and insurance business so extensive that they made the insurance business nearly a separate "corporate entity." Federal law allows banks to set up only units that conduct business banks are allowed to conduct (BI, Sept. 10, 1990).

The Fed ruling meant that Citicorp's Family Guardian Life Insurance Co. unit had to cease selling insurance.

The 2nd Circuit concluded that the Fed ruling was unreasonable, especially because the Federal Deposit Insurance Corp. and the Comptroller of the Currency agree that subsidiaries of state-chartered banks are beyond the scope of the bank act and the Fed's regulatory authority. But a federal bill would bar such sales, so it is unclear whether the

Insurers' duty to defend cleanup suits upheld

By STACY ADLER

DENVER—The pollution exclusion in comprehensive general liability policies does not relieve insurers of their duty to defend a policyholder facing hazardous waste cleanup litigation, the Colorado Supreme Court has ruled.

In a 4-3 decision, the Colorado Supreme Court ruled that the pollution exclusion, which bars coverage for all pollution that is not "sudden and accidental," only bars coverage for pollution that is expected or intended by the policyholder. Because the underlying litigation against the policyholder does not allege this, insurers must defend the policyholder, the court ruled.

Insurers argue that the word "sudden" should be construed to mean that coverage is barred for all pollution that does not occur quickly.

The May 13 ruling by the Colorado Supreme Court marks the

third time a state supreme court has interpreted the "sudden and accidental" provision of the pollution exclusion in favor of policyholders.

In June 1990, the Wisconsin Supreme Court ruled 6-1 that the pollution exclusion does not bar coverage for hazardous waste cleanups (BI, July 2, 1990).

And, in June 1989, the Georgia

"The courts remain split on this issue," agreed Frederick J. Baumann of Rothgarber, Appel, Powers & Johnson in Denver, who represented Industrial Indemnity Co., a Basking Ridge, N.J.-based unit of Crum & Forster Inc., one of the insurers involved in this case.

Industrial Indemnity has asked the Colorado Supreme Court to re-

Excess/surplus directory deadline looms

Business insurance will publish two directories in the Aug. 12 issue, which will also contain a Spotlight Report on the excess and surplus insurance markets.

One directory will list underwriting managers, managing general agents and surplus lines brokers. The second will list surplus lines insurers and insurers that specialize in writing excess liability coverages.

To be listed in the directory of insurers, surplus lines insurers must write at least 50% of their gross premiums on a direct, non-admitted basis; excess insurers must write at least 50% or \$500,000 of gross premiums in excess liability insurance lines.

There is no charge to be included in the directories. Com-

cial markets, said Mr. Lennon, who chaired the NAIC's High-Yield Securities Working Group that drafted the model regulation.

For example, the model regulation emphasizes that "nothing contained in this regulation shall require a domestic insurer to sell or otherwise dispose of any obligation legally acquired prior to the

ward hit because, under the model, they cannot purchase additional high-yield bonds to back high-yielding annuities that already have been sold, he explained.

However, if the 20% cap had been in existence, Executive Life might never have become a major player in the market, Mr. Barnert conceded.

The American Council of Life In-

regulators' oversight of insurer investments and reduce the time it takes regulators to react to new investment products or investments, like real estate holdings, whose value can deteriorate quickly.

For example, the NAIC is proposing a new model law that would provide greater uniformity in the way states evaluate insurers' assets.

al boost

wick Power & Nuclear Services (USA), 40 Broad St., Boston, Mass. 02109; 617-357-6600.

'No frills' claims service

Small, self-insured employers can purchase "no frills" medical claims processing from a new third-party administrator.

Naperville, Ill.-based Mutual Plan Administrators Inc. offers basic claim processing services to smaller self-funded groups that don't need or can't afford more comprehensive services.

The Mutual of Omaha Insurance Co. subsidiary will offer its services to groups with 100 to 1,000 employees, targeting employers with between 100 and 500 workers.

Gary Auch Moedy, president of MPA, said simplified claims processing system, fewer full-time employees and minimal office space will keep overhead low. The company's claims processing system is compatible with most benefit programs and can incorporate any stop-loss provisions or managed care components, like preferred provider organizations or utilization review, he said.

For more information, contact Randy Horn, Senior Vp & Director-Group Risk Management & Claims, Mutual of Omaha Insurance Co., Mutual of Omaha Plaza, Omaha, Neb. 68175; 402-978-2206.

New offices

Insurance Services Office Inc. consolidated its New York operations into a single office at 7 World Trade Center, New York, N.Y. 10048; 212-898-6000.

Industrial Indemnity Inc., is consolidating its Sacramento and Stockton, Calif., to 7405 Greenhaven Drive, Sacramento, Calif. 95822; 916-394-4000. ■

Hartford contests N.J. ruling

TRENTON, N.J.—Hartford Group Inc. says it will ask the New Jersey Supreme Court to review an appellate court ruling that state insurance regulators can require multiline insurers seeking to withdraw from the state's private passenger automobile market to surrender their licenses for all lines of insurance.

Agreeing with a trial court (*BI*, Aug. 20, 1990), the three-judge panel last week upheld a provision in the state Fair Automobile Insurance Reform Act that permits the regulators to revoke the licenses of insurers that selectively withdraw from the state auto insurance market.

The ruling stems from a lawsuit filed by Hartford after regulators ordered it to surrender all of its licenses when Hartford unit Twin City Fire Insurance Co. tried to withdraw from the state's auto insurance market last year. Twin City and the American Insurance Assn., which filed a brief in the case, argued that the 1990 reform law jeopardized insurers' ability to turn a profit. The law requires auto insurers to, among other things, pay \$1.4 billion over the next seven years to bail out the state's Joint Underwriting Assn., a now-defunct pool for bad drivers that is more than \$3 billion in debt.

Auto insurers in the state reported a combined profit of \$29.5 million in 1989, pointed out David Snyder, senior counsel with the Washington, D.C.-based AIA. "It doesn't take much of a mathematician to realize that whatever (profit they) realize will be wiped out by the assessments and surtaxes called for under the law."

—By Michael Schachner

Hospital told to repay insurer

CHICAGO—Rush-Presbyterian-St. Luke's Medical Center in Chicago will appeal or ask for a rehearing of an Illinois trial judge's ruling that it must repay \$6 million to its medical malpractice insurer because the hospital did not promptly notify the insurer of a potential claim that was later settled.

In the underlying litigation, a woman who claimed her baby was brain damaged during delivery at Rush in 1984 sued the hospital for malpractice. Hartford Accident & Indemnity Co. wrote \$1 million of primary malpractice coverage and \$8 million of coverage excess of \$1 million for Rush.

The case was settled for \$6 million in 1987, but Hartford asked the court to order Rush to reimburse the insurer. Hartford maintained that Rush did not give timely notice to the in-

surer that the claim could pierce the excess layer, as required under its policy, said Hartford attorney Francis A. Spina, a partner with Tressler, Soderstrom, Maloney & Priess in Chicago. Although the suit was filed in August 1984, the hospital did not give insurers notice until April 1986, he said.

But, Rush attorney Jeremiah Connolly, a partner with Bollinger, Ruberry & Garvey in Chicago, said the excess policy did not require the hospital to notify the insurer until it appeared "likely" that the claim could pierce the excess layer. And, "there's no way that it appeared likely the excess layer would be invaded until May 1986," he said.

Cook County Circuit Court Judge Richard Curry ruled for Hartford on June 3.

—By Colleen Johnson

In early August 1969, with the nation still agog over the return of the Apollo 11 astronauts from the moon, other news was getting scant attention. Among the little-noticed items was passage of important public-protection legislation by three trend setting states. Within 10 days, Michigan, California, and Wisconsin approved similar plans to expand public protection against the possibility of loss from the insolvency of an insurance company. Henceforth, all valid claims against insolvent insurers will be guaranteed by other insurers doing business in these states.

It was the battle between state level post assessment funds and federal level pre-assessment funds that resulted in the creation of the California Insurance Guarantee Association. While consumer protection and industry image propelled the policy initiative for insolvency protection, it was the threat of national legislation and its embodying a very different solution that led the push for California legislation on this matter.

The legislators made these insolvency laws though insurance company failures did not constitute a pressing national problem. For example, in the field of auto insurance, where companies specializing in covering high-risk drivers have an abnormally high rate of insolvencies, claims against insolvent companies amounted to only about one-tenth of 1 per cent of all claims.¹ Nevertheless, the legislators and insurance men who supported the

¹"Closing the Solvency Gap," The Journal of American Insurance, Vol. 46, No. 5 (November-December, 1970), p. 25.

new insolvency legislation reasoned that such protection was of compelling importance to the individuals directly involved.

To people awaiting payment of a valid claim, news of a company's inability to honor all or part of its obligations could be crushing. Legislators and consumer advocates saw these victims as innocent people already under stress from injury, or financial or property loss. Under existing policy, when an insurance company had been declared bankrupt because it had run out of money to pay the claims held against it and to return premiums collected for beyond the bankruptcy date, policyholders and persons with claims against the company could have faced long court battles and only partial recovery of their claims of unearned premiums.

Another important reason for the concern about insolvencies was that even a single company failure, regardless of how overshadowed by the statistics on the over-all soundness of the industry, could do widespread harm in undermining public confidence in the institution of insurance. The problem of insolvency had actually been on the decline in the years prior to insolvency protection enactment. But the growing concern about consumer protection made both governmental and industry officials aware that final steps had to be taken to complete safe guards against the effects of insolvencies.

For these reasons, insurance leaders and state officials responsible for regulating insurance worked on better ways to close the last gaps in the full protection of the public from the effects of an insurance company insolvency. The plans supplemented protection in 1969 available to citizens of all 50 states through

the uninsured motorist (UM) coverage of their automobile insurance policies, and the increased protection earlier brought about through tighter state regulation of insurers.

Moreover, emphasis on regulation by state insurance departments helped to dry up the sources of the insolvency problem by making marginal companies either conform to the standards of the vast majority of solid companies or get out of the insurance business. In 1967 through 1968, insurance departments tightened their regulation by means such as: expanding investigation of investment practices; giving closer scrutiny to reserving of claims; increasing the number and compensation of insurance department examiners; and supplementing insurance department accounting and actuarial staffs by calling in outside personnel. During those two years, numerous states enacted insurance department programs for strengthening regulatory powers. Ten states enacted general insurance code revisions or had made extensive amendments. Twelve states raised statutory capital and surplus requirements for insurance companies unchanged since 1947.²

The job of regulating the activities of the American insurance industry to this point had fallen on the states rather than the federal government. In 1944, the Supreme Court reversed a 1869 position and ruled (U.S. v. South-Eastern Underwriters Assn.) that no interstate "commercial enterprise" could be considered wholly outside the regulatory power of Congress. "We cannot make an exception of the business of insurance," the Court ruled. In

²ibid.

response to this decision, Congress in 1945 enacted the McCarran-Ferguson Act (PL 79-15). Formally known as the Insurance Antitrust Moratorium Act, the statute declared that the continued regulation of the insurance industry by the states was "in the public interest."³

Before the addition of insolvency protection to UM coverage, UM coverage had proved a great value in extending protection to policyholders when injured and unable to collect from a hit-and-run driver or driver who carried no auto liability insurance, insurers simply extended this coverage to allow a policy holder left with an unsatisfied claim against an insolvent insurer to collect from his own company.

Although most insolvency problems in years previous to debate involved auto liability coverage, the American Mutual Insurance Alliance (AMIA), a voluntary association of more than 100 mutual property and casualty insurance companies, believed that the three plans, enacted in California, Michigan, and Wisconsin, which covered, other types of policies, were desirable because the hardship imposed on the public by the failure of a property and casualty insurance company was potentially just as serious as the hardship imposed by failure of an auto insurer. The UM-with-insolvency protection was available in 34 states by law, and in 13 other states through the voluntary action of most insurance companies. Under this coverage, an auto accident victim collected from his own insurer if he could not collect from a negligent

³"Federal auto insurance study could lead to reform," Congressional Quarterly Almanac, (March 1, 1968), pp. 401-406.

motorist whose insurance company went broke. This protection was provided at no extra charge to policyholders purchasing the UM coverage. UM coverage covers the policyholders if the other party does not have insurance. By 1969, the drive backed by the auto insurance industry had made the UM endorsement for insolvencies available in all 50 states.

It was not until 1967 that Congress took the first step toward possible far-reaching changes in the nation's insurance system. Most of these changes were to deal with automobile insurance. The attention that insurance received was in the form of investigatory committees. Exact information on automobile insurance companies was difficult to come by. Congressional experts who began examining the problem in 1967 noted that Congress had "virtually no current information" on the business condition or practices of automobile insurance companies or on the adequacy of state regulation of automobile insurance. The wide variety of insurance-regulation laws and the efforts of the insurance industry to cope with the soaring number of drivers and accident claims prompted Congressional interest in car insurance in 1967. To the consumer, the condition of the automobile insurance industry was felt chiefly in the increase in premium costs and what sometimes appeared to be capricious cancellation and renewal policies followed by insurers.⁴

Several bills were introduced in 1967 outlining federal action to reform automobile insurance practices. Only one of the bills, however, set forth a substantive program. On January 26 Senator

⁴ibid.

Thomas J. Dodd (D-Connecticut) introduced a bill (S 688) establishing a federal guaranty fund, similar to the Federal Deposit Insurance Corp., to protect policy holders against insurance company insolvencies. Dodd, in a floor speech noted that three states (New York, New Jersey and Maryland) had similar guaranty programs. The federal fund would be established by the Treasury Department with an initial capital of \$50 million, under the provisions of S 688. The Treasury would be paid by exacting a small charge from insurers according to the amount of automobile insurance they wrote a year. The Federal Motor Vehicle Insurance Guaranty Corporation, which would have formed a Federal Motor Vehicle Insurance Guaranty Corporation, was sponsored by Magnuson (D Wash.), Hart (D Mich.), Hartke (D Ind.), et. al. This bill did not get out of Congress.⁵

A catalyst for the renewed discussion of a federal insurance insolvency program in 1969 was the insolvency of State Fire & Casualty in Florida and its subsequent investigation. The Senate Judiciary Anti-Trust Subcommittee, in an attempt to determine the over-all effectiveness of state regulation for insolvency, held hearings regarding the insolvency of State Fire in the spring of 1968. In his opening remarks, the subcommittee's chairman, Phillip A. Hart (D-Michigan), pointed out that State Fire was "one of the biggest companies to go under in recent years.... This bears directly, of course, on the solution which hopefully Congress will

⁵ibid.

enact, a federal insurance fund."⁶ He added that he had introduced legislation to establish such a fund covering all property and casualty insurance companies to insure payment of losses of policyholders and claimants in the event of a an insurer bankruptcy.

Outlining the downfall of State Fire, Florida insurance commissioner Broward Williams said it was a sound company from its incorporation in Florida in July, 1946, until it merged with Windsor Ins. Co. of Chicago. The first indication of difficulties in the company came during its regular triennial examination in early 1967, the commissioner said. Then followed a two year effort by the department to keep State Fire afloat, he continued, so that it could pay its claims and obligations and, at the same time, roll back some of the involved financial transactions undertaken by the new management. Williams explained that Capitol Bank Bancshares, Inc., which owned and controlled the majority of State Fire's stock, was ordered to divest itself of ownership in the insurance company, since it failed to provide sound refinancing of State Fire.⁷

Later, the department discovered that many issues of stock added to the company's portfolio during the reorganization program were "of little or no value" and that many of the stocks were not owned by State Fire, Williams added. "It is common knowledge," Williams reported to the subcommittee,

⁶"State Control of Insolvency," The National Underwriter, Vol. 73, (July 11, 1967), p. 45.

⁷ibid.

that the reserves and surpluses maintained by insurance companies pursuant to regulatory statutes make such companies fair game for modern day charlatans who operate under the guise of being sophisticated financiers--"fast buck boys." The State Fire failure can be laid directly at the doorstep of such persons.⁸

He added that "laws which will operate before the fact to completely eliminate fraud, designed deception of public officials, thievery, embezzlement and other crimes are unobtainable." Furthermore, he said, the National Association of Insurance Commissioners "is aware of and deeply concerned with the known infiltration of Mafia and underworld characters into the insurance industry," and is taking positive steps to strengthen the ability of the state insurance departments to cope with this problem by an increased budget for its unauthorized insurance office and its securities evaluation program.⁹

On May 23, 1969 Senator Warren Magnuson (D Wash.) proposed a bill to the Senate. S 2236, Federal Insurance Guaranty Corporation Act, would have set up a Federal Insurance Guaranty Corporation to protect against property, casualty and surety insurance company insolvencies. The sponsors of the bill included Dodd (D Conn.) and Hart (D Mich.).

There were many groups that were in support of a federal program for insolvency protection. A few groups were not in support of the Federal Insurance Guaranty Corp (FIGC), but felt that the national level was where the regulation should take place. The groups varied from consumer groups and legislators to insurance

⁸ibid.

⁹ibid.

groups. Their reasons for supporting a federal plan include: the plan would aid the states, the states would take too long to implement their own plan, it was preferable to other solutions, and that the states were unable to regulate effectively because they were not uniformed, or simply, the scope of regulation had grown too large.

During the Senate Judiciary Anti-Trust Subcommittee, the Florida insurance commissioner, Broward Williams urged that insolvency funds be set up on the state, rather than the federal level and voiced optimism that his recommendation for such a fund would be enacted by the Florida legislature during the its next session. Hart at the anti-trust subcommittee hearing disagreed, however, pointing out that only three states, New York, New Jersey, and Maryland, thus far have established insolvency funds. "This leads me to believe," said Hart, "it would be better to establish a federal fund rather than to wait for all 50 states to set up guaranty funds."¹⁰

The bill offered funds as well as the assistance of the federal government to the states through its provisions for supplemental personnel and the development of common examination standards which could have been readily applied nationwide. An important argument of the proponents of the federal plan was that the bill did not, on its face, seek to displace state regulation in general or periodic examination for insolvency in particular.

In the opening statement to the Hearings before the Senate

¹⁰ibid.

Committee on Commerce which was set up to hear testimony on S. 2236 in the summer of 1969, Chairman Warren G. Magnuson, said that it was imperative that the committee aid the state regulators in their examinations for insolvency so that situations, like State Fire & Casualty, could be avoided. He went on to mention that like any insurance activity, insurance company insolvency protection must minimize the risk of insolvency while providing resources to pay off those who have claims. He contended, that S. 2236, which would create the Federal Insurance Guaranty Corporation (F.I.G.C), offered a viable solution for this situation. The corporation would have had the power to regulate property and casualty insurance companies and would have been authorized to examine applicable insurance companies and require them to report on their financial condition. The corporation also would have assumed the liability for insurance obligations of an insolvent company. This pre-assessment plan would have provided a nationwide fund for compensating victims and it was set up, asserted Magnuson, to provide State regulators expert help so that they could do a better job spotting companies at risk.¹¹

The American Insurance Association (AIA) which was an organization of insurance companies writing all kinds of property and casualty insurance throughout the country, was the first endorsement of the bill by a major segment of the property-casualty industry. The Magnuson Bill, T. Lawrence Jones, the president Association stated, "prohibits the proliferation of state

¹¹"Hearings before the Committee on Commerce United States Senate, on S. 2236," (November 12, 1969), p. 1.

insolvency funds, which in our judgement, is a totally unacceptable solution," and

unlike all other solutions under discussion, S. 2236 strengthens the regulatory process. It should prove to be especially helpful in preventing the interstate shifting of assets, which has been beyond the reach of state regulatory power and which has been such a significant factor in a number of insolvencies.¹²

Disagreeing with the National Association of Insurance Commissioners (NAIC), which was a voluntary association of state regulatory offices, and other insurance industry witnesses, Jones said the AIA rejects contentions that the legislation portends the end or diminishes the role of the state regulation. On the contrary, said Jones, it complements and supplements such regulation and will strengthen it "by removing a long standing source of criticism." In response to questioning by Hart, he maintained that this "is not a back door to federal regulation; we regard it as a front door to strengthen state regulation." "The sponsors of the bill," Hart replied, "view it exactly the same way."¹³

Other testimony in favor of the federal plan, because it would not displace the states, was the National Association of Property and Casualty Reinsurers (NAPCR) who was represented by Ronald A. Jacks and Henry Kramer. NAPCR was an association of professional reinsurers organized as a nonprofit corporation. The principal function of the association is to serve as a forum for the exchange of views among reinsurers on matters affecting the industry and to

¹²ibid., pp. 106-107.

¹³ibid., p. 121.

serve as a vehicle for the industry to express its views on legislative and administrative questions pending before Congress, the executive branch and several States. Jacks endorsed the creation of the corporation, which he said would supplement and assist regulation of the industry by the states.

Jacks believed that the FIGC would be best suited to serve this function by assisting existing state examination of insurance companies, guaranteeing nonlife policies issued by companies engaged in interstate commerce, and assessing those companies to pay for losses arising out of insolvencies not otherwise funded. Jacks also said that if the government moved into the picture, there be a fundamental realignment of the insurance regulatory structure, presumably for the better. Kramer noted that reinsurance companies, companies which insure other insurance companies that deal mainly with the consumer, would not be affected by the FIGC.¹⁴

Another argument the by the supporters of the federal plan was the that in view of the other options, it was preferable. The choices included the pre-insolvency assessment fund, such as the FIGC, a state level post-insolvency fund, and a variation of the two at the federal level. "AIA for Federal Insolvency Fund, Bucks the Industry," read the read the title of an article in The National Underwriter on November 28, 1969. At the testimony before the Senate Commerce Committee the Association said the proposal was preferable to all the other proposals and "provides a sure way to

¹⁴ibid.

protect members of the public against the possibility of insurance company insolvency."¹⁵ The arguments by, AIA president, in support of the bill, detailed deficiencies found after intensive examination of alternative federal and state-level proposals for insolvency protection. His testimony ran counter to that advanced against the bill at the hearings by other major insurance industry organizations and by state insurance authorities. Jones also had a special committee explore all aspects of the insolvency issue for several years. This unit examined all possible alternatives before reaching the conclusion that the proposed FIGC, patterned after the Federal Deposit Insurance Corporation, was "clearly preferable to all other proposals."¹⁶

Two other groups that supported a national role in insolvency protection, but not the FIGC were the Insurance Company of North America and the Department of Transportation (DOT). Charles Cox, president of the Insurance Co. of North America (INA), gave limited support to the bill. INA was one of the largest underwriters of property and casualty insurance, writing substantially all lines of insurance throughout the United States and in many foreign countries. Cox indicated that INA was vitally interested in matters affecting the insuring public, and the integrity of "our insurance." He said, that he was sympathetic to the objectives of S. 2236 to protect the consumer from being financially injured when

¹⁵"AIA for Federal Insolvency Fund, Bucks the Industry," The National Underwriter, Vol. 73 (November 28, 1969), p.1.

¹⁶"Hearings before the Committee on Commerce United States Senate, on S. 2236.", op. cit., p. 102.

an insurance company became insolvent. However, Cox thought there were better ways to accomplish this. He suggested federal establishment of a voluntary or compulsory fund which would respond when a participating company became insolvent, a sort of federal level post-insolvency assessment fund.¹⁷

The other group that supported federal regulation, but not the FIGC was the Department of Transportation (DOT) which gave the administration's view. The administration was strongly in support of federal legislation to guarantee that every citizen, every policyholder, and every claimant is properly and fully compensated for his insured losses. DOT presented an administration proposal for consideration the next month. The record of the American insurance industry and the state system of insurance regulation fully demonstrated that the vast majority of these consumer rights were properly protected. The different departments within the administration were concerned with different aspects of insurance insolvency protection. DOT was concerned with auto insurer insolvency, while the Department of Commerce was more concerned with broader aspects of problems, including the possible effect of insolvencies on the confidence of our citizens in the business community and the proper treatment of the consumer in business. Although the problem area was modest in comparison with the insurance in force nationwide, asserted DOT, the adverse impact of

¹⁷ibid., pp. 62-65.

insurer insolvencies, especially on individuals and smaller insureds, warrants federal legislation.¹⁸

Another argument in favor of federal supervision over state regulation was that states were not uniform. The NAPCR took this stance in their belief that the power and authority granted regulators in various states was not uniform or not always what the regulator felt was appropriate for specific situations confronting him from time to time. A number of states and industry representatives had conscientiously sought to meet the crisis by pressing for enactment of state insolvency laws of certain types, maintained Jacks. The point of all the activity, asserted the NAPCR, was that nearly everyone seemed to agree there was a genuine problem with respect to detecting and preventing insurance company insolvencies. The difference came in devising the most effective and acceptable solution.¹⁹

Another assertion that the proponents of federal regulation made was that the insurance industry had grown too large and complex, thus increasing the scope of needed regulation to a point out of reach of the state regulatory offices. Jacks, representing the NAPCR said that the states had regulated the insurance industry for many years, since the enactment of the so-called McCarran-Ferguson Act (15 U.S.C. 1011, et seq.) ceding jurisdiction to the states to regulate the business and granting immunity from the federal antitrust laws to the extent that such activities were

¹⁸ibid., pp. 274-279.

¹⁹ibid., pp. 20-24.

effectively regulated by the states. Since that date, asserted Jacks, the states had enacted a series of laws designed to carry out the congressional mandate and justified their continued delegation of federal power. Over the years, continued Jacks, both the state regulators and the insurance industry in general had grown increasingly sophisticated and powerful.²⁰ In most cases these forces had operated for the public good. However, continued Jacks, even supporters of state regulation conceded that it can be strengthened, particularly in the area of detecting insolvencies and devising some just means of compensating the innocent victims of such tragedies.

Consumer interests also came forward to endorse the bill on grounds that the states were ineffective without centralization. Erma Angevine, executive director of the Consumer Federation of America (CFA), said the state-by-state treatment of insurance company insolvency was not effective. CFA was an organization of 140 consumer groups located in 38 states and the District of Columbia. Their purpose, said Angevine, was to promote the cause of the American consumer and to encourage developments in all areas of the American economy that will operate to the consumer's benefit. "The fundamental weakness of existing regulation," she said, "can not be corrected on a state-by-state basis. Without a central enforcement agency and communications center, disasters...can not be prevented."²¹

²⁰ibid., p. 21.

²¹ibid., p.261.

One of the final arguments in favor of the federal system was based on dissatisfaction with the existing system. John Yolton, administrative assistant of the United Automobile Workers (UAW), exhibited this position. The UAW had a record going back a number of years, claimed Yolton, which indicated their strong drive to seek meaningful reforms in a number of areas of American life. "Our members have felt the sting of insurance company insolvencies," he said. "We have been powerless as individuals or as an organization to cope with the problems that have arisen."²²

On the other hand, many groups that were against a federal insolvency program because of many reasons: the belief that there was no problem, that the states were equipped to handle the problem, the federal plan would have stripped the states of their regulatory power, and that the federal government's record use of guaranty corporations was not that stellar. The groups that held these positions included legislators, insurance groups, states' insurance commissions and social scientists.

An argument against state regulation and for federal regulation was that with federal regulation there would be centralization. Insurance, Government, and Social Policy²³, written by social scientists questioned the assertion that a major advantage of national insurance regulation was that instead of dealing with 50 different state agencies, insurance companies would only have to deal with one in Washington. "This is pure illusion,"

²²ibid., p. 249.

²³Spencer L. Kimball, Insurance, Government, and Social Policy (Homewood: Richard D Irwin, Inc., 1969), p. 417.

said the Spencer Kimball. Not only is it likely that if there were a national insurance commissioner he would have to decentralize his operation and regulate regionally with respect to many things, but, continues the author, it is certainly the case that "insurance regulation" would be fragmented among many agencies. If the bar of the McCarran-Ferguson Act were removed, maintains the writer, surely the Securities and Exchange Commission would aggressively move further into the field of insurance regulation. Nor, continues the writer, is there the slightest prospect that the Department of Justice or the Federal Trade Commission would quietly withdraw. There was also no doubt, said the author, that the Internal Revenue Service would continue its interests in the insurance industry no matter what the regime of regulation might be, and its impact on insurance accounting, at least, would continue to expand. Also he said that the tendency to fragmentation is greater with the more complex government. I was unable to find any groups that went to this detail to unmask the nightmare of increased centralization, and it seems that the writer constructed this vision to counteract a powerful argument against them. It is uncertain if this was a widely held belief, or is it known how persuasive his arguments were, or could have been. One thing that is for certain is that it plays on our general feeling that more government means more complex government, which was all that need be said.²⁴

²⁴ibid.

A second point the author made, which is not far from the first, is that it is not likely that there would be a clean sweep of the state agencies if federal regulation was implemented. It would be a long time, maintained the author, before we would see the last of them. Again while at the state level reasonable accommodation seems usually to be reached between state agencies of a single state, and quite often even among the various departments in the several states, life is said to be different in Washington. Internecine warfare among agencies is said to be a law of life. Each seeks to expand its jurisdiction with "imperialistic aggressiveness." "Overlapping and conflict of jurisdiction is endemic on the Potomac."²⁵

The author challenged another argument of advocates of national regulation: that state regulation was only as strong as its weakest link. State regulation should be judged in terms of its effectiveness in the protection of policyholders. In 1965 New York licensed companies wrote 79.5% of the property and liability insurance business of the country and 65.5% of the life insurance business. If New York regulates its licenses effectively, two-thirds of the life business and four-fifths of the property and casualty business of the country is well regulated, and that percentage of policyholders, says the writer, are well protected at least with respect to those matters that New York really regulates. If California and Texas and Wisconsin and Illinois and Massachusetts also regulate their licenses well, the percentage to

²⁵ibid., p. 418.

the business of the country that is regulated mounts to overwhelming heights. As long as a hand full of critical states are able to handle their regulation satisfactory, then a majority of the companies, therefore policyholders, would be protected. The writer tells us that a dozen such overlapping circles would cover most of the country's insurance business. This does not assert, the author reminds us, that licensees must be regulated as closely as domiciliary companies, companies which are based in one state, but only that they be regulated well enough to give reasonable protection to policyholders.²⁶

At this point the author stopped arguing efficiency or flexibility, and moved toward an argument regarding the implications of dysfunctional state regulation. He states, that even if the state level does not work it is not much of a loss, relatively. If a few policyholders should remain in states with inadequate regulation who are hurt because they buy from companies not licensed by any single state with good regulation of its licensees, that is unfortunate, of course, but its dimensions as a weakness in our social organization should be kept in perspective. Hundred percent protection of all policyholders in the country with equal and complete adequacy is simply not among the most urgent of the problems that face us as a nation. It is far down in the priority list, particularity since the social cost

²⁶ibid., pp. 419-420.

of hundred percent protection may be very high, and ultimately not worth the cost.²⁷

Finally, the author counters the argument that state level regulation would not be uniform. His first point was that national regulation would not necessarily be as uniform as was usually assumed, as already indicated. Lack of uniformity is inherent in a large and continental economy. Second and conversely, uniformity had already been achieved by interstate cooperation in such things as the form of annual statement and the actuarial laws of the life insurance business, where it really matters most. He asserts that nationwide operation is possible. Such uniformity as is really essential could develop despite state level regulation. Third, much more could be done to produce substantial uniformity, and current developments in the National Association of Insurance Commissioners (NAIC) may presage increased uniformity, such as an effective central office. When there is a large enough problem, such as insolvency, that warrants attention the states would take care of it. Part of the problem, maintains the writer, of developing uniformity is the uncertainty what regulation should be like. Lastly, the author believes it can be suggested that uniformity is a much overrated virtue. There are matters with respect to which uniformity would be helpful, but many others as to which it could hardly matter less. Indeed, concludes the

²⁷ibid.

writer, there is also an advantage in diversity, where local conditions vary, or perhaps simply to permit experimentation.²⁸

Although the Department of Transportation (DOT) was in favor of the federal government regulating insolvency, they offered significant criticism of this federal fund. DOT said the fund "represents an unsound method of accomplishing the goal of protecting insurance purchasers." The Committee listed a number of "fundamental weaknesses from the standpoint of broad public policy." "S. 2236 creates a basic dilemma," said the Committee, it would seek to resolve by an impossible compromise. It would create a Federal Insurance Guaranty Fund by levying a tax on all policyholders throughout the country. Then it would provide for federal administration of the solvency fund and federal participation with state insurance supervisors in the financial supervision of insurers and in the administration of insolvent insurers. It evidences a purpose to preserve the pattern of existing state regulation, yet at the same time recognizes that the administrators of the federal fund cannot rely entirely upon state regulation. Actually, the Committee asserts, "the bill would create a dramatic counter incentive to the fulfillment of the objective of sound financial supervision of insurers."²⁹

Another argument was that the state that did a poor job of regulating would get a "free ride" on the coattails of the states that did a good job of regulating. DOT said the very states which

²⁸ibid., pp. 420-421.

²⁹"Hearings Before the Committee on Commerce United States Senate, on S. 2236.", op. cit., pp. 274-301.

did the poorest jobs in the past of regulating their insurers "would further lose incentive" toward tight regulation, because losses in these states would be paid for largely by people in other states. "The only control offsetting this economic counter incentive," said the Committee, "would be the aggressive utilization by the federal agency of direct powers conferred upon it by the bill. This would however, automatically result in the superimposition of a system of a system of federal supervision on the existing pattern of state regulation. Inevitably, said the Committee, the federal agency, to protect the integrity of the fund it would administer, would find it had to reach further and further in the exercise of the powers conferred upon it or to seek even more powers."³⁰

Financial supervision is the primary purpose and function of insurance regulation. The needs of financial regulation pervade the legal controls imposed upon insurers...Comprehensive federal control will, indeed must, follow federal financial responsibility. Hence, S. 2236 manages to create two powerful incentives in conflict with each other and with prevailing attitudes toward federalism: First, it creates an incentive to the states to do an inadequate job of supervision and control of insurers and, second, it creates an incentive for the federal agency to become even more involved in that task.³¹

A better course, the Committee asserted, would have been to protect the public while

preserving the pattern of state insurance regulation, creating incentives for sound financial control, minimizing the need for federal bureaucratic involvement

³⁰ibid.

³¹ibid.

and avoiding the inefficiencies and frictions of duplicated administrative activities.³²

The Committee added its belief in the value of permitting a range of alternative methods of accomplishing these results at a state level.

In the argument against federal regulation, opponents took up the issue of the states' position after federal control. At the Hearings, Senator Hartke differed with committee chairman Magnuson as to the bill's effect on regulation. "It makes no difference how you assess this," said Hartke, "that is, whether it would mean federal usurpation or state abdication, what you have here is the ultimate assumption of federal regulation."³³

This view was echoed by many people in the industry and the insurance industry. On the industry side, it was said, that the, proponents of federal regulation of insurance apparently will not stop until they have turned the business into a "public utility, controlled and dominated from Washington. That was the observation of Senator Roman L. Hruska of Nebraska, the ranking Republican member of the Senate's Anti-Trust Subcommittee.³⁴ Hruska went on to say that the federal government relinquished control to the states they responded by forming a strong system of regulation. However, he voiced his feeling that the states should act as soon

³²ibid., p. 28.

³³"Perfecting the Defenses Against Insolvency," The Journal of American Insurance, Vol. 46, No. 1 (January-February 1970) pp. 28-29.

³⁴"Federal Control Proponents Hit by Sen. Hruska," The National Underwriter Extra, Vol. 73 (November 24, 1969), p. 6.

as possible, or face the possibility of increased federal meddling. "We live in a lively age, and our regulatory system, must be responsive to today's activity," he said. "If it is not, the price will be federal regulation."³⁵

Insurance groups also voiced the fear that this bill would lead to the displacement of state insurance regulation. Andre Maisonpierre, vice president of the AMIA indicating that his association believed that the ultimate result of S. 2236 would be to replace state regulation, and possibly state taxation, of insurance companies by federal regulation. Stressing that the Alliance's major objection to S. 2236 was that it would ultimately replace state regulation of insurance by federal regulation, Maisonpierre said, "it is axiomatic that whoever regulates for insolvency also regulates the total insurance industry."³⁶

The National Association of Independent Insurers (NAII), which represented more than 350 stock and mutual companies writing half of the automobile insurance in the United States, also warned that a federal insolvency fund would mean federal regulation, a fact that has been echoed Senator Vance Hartke of Indiana. At the Senate Hearing on S. 2236, Hartke told a witness: "This bill would mean complete federal regulation. You can't do this piece-meal. It will preempt state regulation."³⁷ The NAII also explained that a federal insurance guaranty corporation would be applicable to all

³⁵ibid., p. 7.

³⁶"Hearings before the Committee on Commerce United States Senate, on S. 2236.", op. cit., p. 68.

³⁷ibid., p. 27.

property and casualty insurance, not only auto insurance. It would have not only the power to examine, he said, but would also be allowed to remove directors and officers of companies, set rates, settle claims and otherwise do whatever on its opinion is necessary for the protection of insurers, policyholders, or the corporation. The insurance insolvency problem, he remarked, can be adequately handled through normal insurance channels. UM with the insolvency provision, which independent companies pioneered, is just one way in which this was being accomplished.³⁸ The NAII also said that the FIGC would result in federal takeover of an area of regulation which the states were quite competent to deal with, "contravening the trend to return regulatory authority to state and local governments wherever feasible."³⁹

In addition to the fear of a displacement of state offices, a greater fear touched on in the last few comments, was the fear of total insurance regulation by the federal government. Hruska took note of the fact that in the past dozen years, a number of strong assaults had been made on the concept of state regulations. There have been bills in Congress to impose federal regulation on alien excess lines coverage (a form of property and casualty insurance), to control credit insurance, and most recently, asserted Hruska the bill to create a federal insurance guaranty corporation. "In each case we have been told that the bill was merely aimed at a specific problem. But make no mistake," he

³⁸ibid., p. 40.

³⁹ibid., p. 37.

warned. "The real goal, and one that the sponsors never lose sight of, is complete federal regulation [of the insurance industry]." ⁴⁰

Hruska also countered the federal proposal with the argument that industry's voluntary efforts offered protection by showing responsiveness to the public demands, such as with UM coverage. "It would be foolish to deny that public confidence in the business has been shaken by these hearings and by sensationalized testimony of some of the witnesses," Hruska said. "Clearly these charges must be answered, not by rhetoric, but by action." Typical of the industry's efforts to meet the challenge is the fact that uninsured motorist (UM) coverage, with the insolvency clause, had been extended to all 50 states, thus affording protection to nearly all of the driving public. State regulation had been recommended by the National Association of Insurance Commissioners to make the figure 100%, he said. "And the business is to be commended for its special attention over the past few years to consumer demands, particularly in the areas of auto and casualty coverages," remarked Hruska. ⁴¹

Finally he urged the NAAI members to renew their efforts to bolster state regulatory machinery by updating outmoded and ineffective legislation setting forth the authority of state commissioners and by providing adequate financing and staffing for state departments. The surest way to avoid control from Washington is to make certain that the job is done well in the state capitals,

⁴⁰"Federal Control Proponents Hit by Sen. Hruska," op. cit.

⁴¹ibid.

said Hruska. Consumer standards, concluded Hruska, adopted by each state, would be a long step in the right direction.⁴²

This opinion was also taken by the AMIA. The Alliance spokesman noted that the problems of insurance company insolvencies were presently being resolved at the state level on two separate fronts. On one hand, state legislatures have acted forcefully to prevent insolvencies by providing state insurance regulators with stronger regulatory controls and authority over insurance companies. With these additional powers, state insurance departments have developed methods to detect potential failures due to incompetent management and have been able to plug loopholes through which unscrupulous operators have occasionally succeeded in infiltrating the business. On the other hand, the insurance industry and the state legislature have acted to develop programs to protect the victims of insurance company insolvencies.⁴³

The NAIH also took the position that normal channels are best suited for regulation and that this had been proven in the past. UM with the insolvency provision, which independent companies pioneered, is just one way in which measures were instituted when needed were accomplished.⁴⁴ His final reason for his opposition to the FIGC was that it ignored the fact that states and the insurance industry were taking very adequate measures to further reduce

⁴²ibid.

⁴³ibid., pp. 69-70.

⁴⁴ibid., p. 40.

insurance company insolvencies and their consequences to the "point of insignificance."⁴⁵

Another argument that opponents of the federal bill used was that the insolvency problem was not that great, and thus did not warrant drastic federal regulation. The AMIA told the committee that, "there is no justification for the possible imposition of federal regulation on a business presently regulated by the states."⁴⁶ The Alliance continued by saying the insolvency problem simply did not approach the magnitude of a national social issue that required drastic measure that were proposed under a current federal bill. However, it was recognized that there should be some form of protection for even the minute segment of the public from losses occasioned by insurance company insolvencies.⁴⁷ The NAII agreed by remarking that while today's minimal insurance insolvency problem may still require some medicine, there is no need for the drastic surgery that another "federal gargantua" with of its attendant administrative expenses would impose.⁴⁸

Many of the supporters of federal regulation likened the FIGC to the Federal Deposit Insurance Corporation (FDIC). This analogy, was attacked by the opponents of the federal plan in regards to the

⁴⁵"Hearing before the Committee on Commerce United States Senate, on S. 2236.", op. cit., p. 37.

⁴⁶ibid., p. 73.

⁴⁷"New State Laws Provide Protection for Policyholders Against Insolvencies," The Weekly Underwriter, Vol. 201, No. 10 (September 6, 1969).

⁴⁸"Strong Plea for State Regulation Made by Lemmon," The National Underwriter Extra, Vol. 73, (November 24, 1969) p. 1.

FDIC's creation, efficiency, and cost. Part of the uproar was the claim that conditions in the insurance industry of the time were analogous to the conditions in the banking industry of the 1930's and early 40's. On that subject, an issue of Barron's dated January 2, 1967, states:

Even during the prosperous roaring 20's, an average of more than 580 banks failed every year: in the first four years of the Depression, 1930 through 1933, over 2,220 closed annually, climaxed by some 4,000 in 1933.⁴⁹

Barron's figures placed bank failures in the six years preceding the creation of the Federal Deposit Insurance Corporation at something over 10,000. But even under 34 years of FDIC regulation, implemented by 1,100 federal examiners and tens of millions of dollars of annual administrative expense, bank failures had averaged more than 22 a year, the article noted. During the last 25 year, the bank failure rate has been just under 10 per year. From 1945 to 1959, a total of 98 insurance companies failed. From 1960 to 1965 an additional 58 went out of business. So the total number of insurance company failures in over 20 years has been 156, or 7.5 per year.⁵⁰

Insurance interests expressed the same view. The NAII said the analogy was an invalid point because the FDIC was born out of a serious economic depression in which more than 9,000 banks failed. The circumstances, the NAII said, are the direct antithesis of the picture in the insurance business, where 99% of

⁴⁹Herbert R. Preston, "Insolvencies: A proper perspective," The Journal of Insurance Information, Vol. XXVIII, No. 5 (Sept-Oct, 1967), pp. 2-5.

⁵⁰ibid.

the companies are in sound financial condition and have the complete confidence of their policyholders. "Those who seek a federal answer to every problem," added the NAII,

invariably endeavor to build their case upon the fact that state regulation is something short of 100% effective. I've been waiting for someone to point out to me at least one agency that has attained or approached that shining mark. In fact, I seem to note an increasing tempo of criticism being directed at Washington on a variety of counts.⁵¹

Efficiency of federal agencies, such as the FDIC, was also another analogy attacked by the opponents. Insurance Commissioner Lorne R. Worthington of Iowa, chairman of the Executive Committee of the National Association of Insurance Commissioners (NAIC), commented on the shortcomings of federal agencies in testimony for the Senate Commerce Committee. "It is a common complaint among federal administrators," said Worthington,

that their agencies are substantially understaffed, underfunded, and unable to fully perform all their functions. One can read in the daily papers illustrations of the absence of perfection in the performance of various duties ranging from neglect, delay, omissions, overzealousness, and even being taken in by fraudulent schemes from time to time. A federal regulatory solution is not a panacea.⁵²

In addition the complaint that the FDIC and the FIGC were created under different circumstances, other opponents of S. 2236 questioned its backers assumption that federal regulatory agencies were by their nature economical. They pointed out that the FDIC was an extremely costly operation, having collected some \$4 billion

⁵¹ibid., p. 41.

⁵²"Hearings before the Committee on Commerce United States Senate, on S. 2236.", op.cit., p. 138.

from American tax consumers since its inception, while paying out only \$55 million in net losses. That is \$75 in taxes for each \$1 in benefits delivered.⁵³

In addition, the American Mutual Insurance Alliance (AMIA) objected to the cost of a Federal Insurance Guaranty Corporation. The AMIA pointed out that the corporation's annual administrative costs alone would be in excess of \$36 million. Conversely, the administrative costs of state run plans would be negligible since these would call for no additional administrative personnel.⁵⁴

The NAII also pointed out that state regulation and the availability of uninsured motorist (UM) coverage with insolvency protection in all 50 states have helped reduce the actual losses from insolvency to only about \$1 million a year. This represents 1/100th of one per cent of all automobile liability insurance premiums written. In contrast, the NAII estimated that the cost of administering a federal guaranty fund could go as high as \$60 million a year, meaning that to handle \$1 of insolvency loss the federal government would spend \$60.⁵⁵ In its conclusion before the Senate Commerce Committee the NAII said the FIGC "would be

⁵³"Closing the Insolvency Gap," The Journal of American Insurance, (Sept-Oct 1969) Vol 47, No. 6, p. 20.

⁵⁴"Mutual Alliance Calls Insolvency Bill Unnecessary and Inappropriate," The National Underwriter, Vol. 73, (November, 21. 1969) p. 12.

⁵⁵ibid.

inherently so cumbersome and expensive that the supposed cure would be put of proportion to the problem."⁵⁶

Among the state insurance commissioners, there was no support for the federal plan for a variety of reasons generally shared by all in opposition. Lorne Worthington, representing the National Association of Insurance Commissioners (NAIC) at the Senate Commerce Committee on the proposed bill said it would

superimpose an additional layer of duplicative and costly regulation at taxpayers expense--on an already intensively regulated industry. The creation of a federal group with extensive regulatory powers would erode the effectiveness and could ultimately destroy the time-tested system of state insurance regulation.⁵⁷

In addition to other arguments against federal regulation, or any regulation for that matter is the fear of overregulation. This was the opinion of the NAII which noted that there was a tendency to overregulate at any level of government, but the NAII said that it could be as great as 50 times as much when it emanates from Washington as from an individual state. Though state regulation has its flaws, concluded the NAII, those problems are being solved. "Continued support for state regulation will serve the public interest better than another federal bureaucracy," he said.⁵⁸

Perhaps the Magnuson bill drew so much criticism because it embodied an idea that events had passed by. The idea of a federal insolvency fund had first been proposed a few years before (S. 2236

⁵⁶"Hearings before the Committee on Commerce United States Senate, on S. 2236.", op. cit., p. 37.

⁵⁷ibid., p. 140.

⁵⁸ibid.

by Senator Thomas J. Dodd (D-Connecticut)) at a time when the public had much less protection from insurance company insolvencies than it did in 1969. The proposal had served the honorable function of drawing attention to a problem by proposing a drastic solution of federal level regulation. But in 1969, it had become irrelevant, due to the fact that the states and insurance industry were capable and were, in fact, handling the problem. In the years prior to the bill, innovations by insurers and their state regulators had virtually closed the insolvency gap.

Not everyone in the industry felt that there was a problem with the level of insurance insolvencies. One such person was Herbert R. Preston, Chairman of the Insurance Information Institute,⁵⁹ who said the insolvencies were but a relatively small flaw in a total business operation which on the whole was a well-managed and responsible operation. He said that the people who talked about insurance company insolvencies lost perspective of the extent of the problem. He made this assertion by analyzing the statistics involving insolvencies. Preston tells us that there were 58 insurance companies that had become insolvent from 1960 to 1965, stating that 300,000 policyholders and claimants had been left stranded.⁶⁰ He said that from 1960 to 1965, most of the states, 29 of the 50, had no insolvencies at all. And more than half of the 58 insolvencies that did occur came in only four states. He added that the insurance department and legislatures

⁵⁹Herbert R. Preston, op. cit.

⁶⁰ibid., p.3.

of these four states were currently enacting remedial laws. That left the remaining 46 states with a failure rate of one-tenth of a company per state per year, barely a "critical problem." In a country with 90 million registered motor vehicles, many with more than one driver, the figure of 300,000 "stranded" policyholders and claimants comes to less than one half of one percent of those covered, said Preston.⁶¹ Thus, only 43 hundredths of 1 per cent of the auto premiums written during this time were written by those ill-fated companies. Preston concluded by saying that the misplaced emphasis ignores the fact that literally hundreds of thousands of claims are paid day in and day out, in a fair, prompt and equitable manner.⁶²

Many, if not all of the opponents of federal regulation, if they felt there was a large enough problem to warrant action, believed that it could be best accomplished at the state level. At stake, as mentioned earlier was the traditional state role as regulator of insurance that did business in their jurisdictions. The federal proposal, many the opponents feared, would have taken the regulation out of the hands of the states. Many believed that the federal bill's passage or rejection by Congress depended on the extent to which the states showed their willingness to quickly bring full insolvency protection to the insuring public. If the states failed to take this last step in protecting the public against insurance insolvencies, many observers felt a federal

⁶¹ibid., pp. 3-4.

⁶²ibid. p. 5.

agency, such as the FIGC, would take over the job. If that did occur, another fear that the states faced, was that the likely repercussion would have been the ultimate loss of the \$929 million that was collected each year by the states from insurers in fees and premium taxes. With the prospect of federal regulation very real, the state insurance commissions, with backing from some of the insurance industry proceeded to initiate state level plans.⁶³

The states moved quickly in response to the prospect of insolvency protection at the federal level. California was one such state that acted quickly. The insurance industry and the NAIC were the primary movers in the strive towards post insolvency plans. There was general agreement in the insurance industry that the problem of insolvencies was small it did warrant action, however, not all felt there was a large enough problem to warrant any action.⁶⁴ State level advocates' arguments were similar to those of the opponents of federal regulation, which focused on the efficiency and the inexpensive nature of a state sponsored post-assessment insolvency plan.

As implied in the arguments against federal regulation, insurers preferred the post-insolvency plans because no funds would be collected in advance, and no elaborate administrative machinery would have been required. The AMIA pointed out the direct availability of a state insolvency located in the state under the supervision of the state insurance regulator. The state insolvency

⁶³"Perfecting the defenses against insolvency," op. cit., p. 28.

⁶⁴Herbert R. Preston, op. cit.

plans also provide incentives for sound financial supervision of insurers. This is because these plans put pressure on the state regulators to move in promptly and prevent insolvencies since they would otherwise have to face the consequences of their failures by assessing the surviving companies and their policyholders. The National Association of Insurance Commissioners (NAIC) also supported the post insolvency plans of the same reasons.

In addition, other arguments, such as the states flexibility, in favor of state regulation were made. The National Association of Mutual Insurance Agents (NAMIA) which represents 18,000 independent mutual insurance agents, argued in favor of state regulation because of the flexibility at the state level, but proposed the adoption of a national concept of standards for the states to look to for guidance. Lastly, the NAMIA also remarked that the states were uniquely qualified to do the job because though insurance is national in scope, it is closely identified with the immediate needs of the local public it serves.⁶⁵

Independent social scientists advocated state level plans for further reasons. These included: the state system was already known, the states permitted experimentation, and that the insurance lobbying machinery would work best for the public at the state level. In the book Insurance, Government, and Social Policy⁶⁶, previously noted, the author asserted that one, certainly real,

⁶⁵"Hearings before the Committee on Commerce," op.cit., p. 237.

⁶⁶Spencer L. Kimball, op. cit. pp. 414-421.

advantage of state regulation is that it is an established and known system. Its assets and liabilities are familiar. Devices for limiting the impact of the weakness have reached a high level of sophistication. "Nothing," the writer said, "is so unsure as the prediction of the full range of consequences of a major change in a complex organic system."⁶⁷

The second assertion the author made for the advantage of state regulation was that it did not require a total commitment. Historically, there have been some occasions on which insurance companies have in fact withdrawn in numbers from states where legislation that was perceived as unreasonable was enacted. Not only is actual withdrawal an important escape that is available to insurers, the ultimate weapon against unfair regulation, the author tells us, but the threat of withdrawal is even more important as a lever against a state legislature that is proposing unwise legislation. It is extremely costly and difficult to do business this way, but it shows that the availability of withdrawal helps greatly in the resolution of otherwise difficult controversy. It should be clear, the writer assures, that there would be no comparable weapon in the industry arsenal if there were national regulation.⁶⁸

Again, an asserted and real but inadequately exploited advantage of state regulation is the chance it provides for cautious experimentation, for trying new techniques without total

⁶⁷ibid., p. 414.

⁶⁸ibid., p. 415.

commitment. This was also noted by the NAIC. This is closely related to the last point. As another asserted advantage of state regulation and certainly an advantage to the insurance industry if not clear one to the public, it can also be said that the industry has more than enough capacity to deal effectively with most state regulators and most state legislatures. In the first place, the lobbying machinery is operating and well oiled at the state level, and the industry's weight seems heavy to the average state bureaucrat and legislator. It is not so clear that the industry can deal with equal effect under all circumstances with the national bureaucrat or with members of Congress. There is much more muscle in Washington, the author suggests, and under certain political situations, the representations and interests of the industry can be ignored in a way that is likely in any state, even the largest. No matter what the political context, competition among the states provides a kind of leverage totally absent in Washington. Though one speaking for the public interest might be expected to opt for the system where the industry's lobbying weight is less likely to be decisive, the author does not think so. Though he thinks it unfortunate for it always to prevail, he believes that it is desirable for the industry to have to be listened to.⁶⁹

Moving from these pragmatic considerations in which the author has focused on industry desires and powers, the author suggested that there is importance to our society, altogether transcending

⁶⁹ibid., p. 416.

and overriding industry interests, of some fundamental political values urging state level regulation. The very basis of our federal system is at issue, explains the author. Decentralization and dispersion of political power is in itself an important value in a democratic society. Concentrations of power are bad per se, and it is irrelevant whether the concentrations are in government, in labor, or in business. In any case they are in people. The author says that undue concentration of power in Washington is unwise from any point of view. Any problems that can be dealt with adequately at the state level should be handled there in preference to Washington. He asserts this generally and categorically. He does not have any ideological objection to public intervention in private business. Indeed, in his view private business has a claim to exist only if it serves the public welfare. He is quite relaxed about the prospect of extensive government intervention in any business, whenever good reason can be shown. But he does fear concentration of power in one city, or one river, or in one man, or in one commission. A single controller of insurance companies has altogether too much power. Even the best regulator, state or federal, the writer asserts, can have too much power if his reach is too long.⁷⁰

However, the proposal for a federal agency was valuable in that it did underscore the need for further protective legislation. The states soon followed up with their action on post-insolvency legislation which enabled the insurance industry to guarantee the

⁷⁰ibid.

swift payments of all obligations. In essence, in states with post-insolvency assessment plans, the burden of the waiting period was shifted from the customer to the insurance companies.

On March 27, 1969, California Assemblyman John V. Briggs read for the first time, an act to amend the Insurance Code to create the California Insurance Guarantee Association. The catalyst for the creation of Assembly Bill (AB) 1310 was the pressure put on the states by the pending federal plan. It was the feeling that if the states did not take this step in protecting the public against insurance insolvencies, a federal agency would have taken over the job. This is not to say that there was a genuine belief that the state were able to do a more adequate job.⁷¹

In addition to the pressure put on by the federal government, was an insolvency in the state. Key Insurance Exchange was placed in conservatorship by the Insurance Commissioner in 1969. It was estimated that Key's liabilities exceeded its assets by about \$500,000. Since Key Insurance was a reciprocal insurer, owned by the policyholders, its policyholders had to be assessed one additional year's premiums in order to pay claims against the company. AB 1310 would attempt to overcome this by providing that the Guarantee Association would pay the claims, thereby relieving the Key Insurance policyholders of any assessments.⁷²

⁷¹Richards Barger, Insurance Commissioner (1969); telephone interview, (April 1991).

⁷²"Notes of John V. Briggs-AB 1310," California State Archives.

The California Department of Insurance, drafted a bill and promoted it in the legislature.⁷³ Richards Barger, the insurance commissioner, was also a member of the National Association of Insurance Commissioners (NAIC), one of the strong opponents of the Magnuson plan. In 1970 the NAIC had created its own model bill state legislation. The Department of Insurance made six arguments for AB-1310: (1) AB -1310 would make insolvency funds available for all insurers in California which provide property and casualty insurance. With the overall effect being that all members of the public in the state would be assured that their claims would be paid despite the fact that a company would have become insolvent. (2) The plan provides that in an event an insurer becomes insolvent, all the other companies via the CIGA would respond to the claims against policies which had been issued by the insolvent company. No advance fund was created, but the Association responds as need be with the costs shared by all its members. (3) There would be an immediate effect, helping the policyholders of Key Insurance. (4) The

enactment into law of AB-1310 will evidence ample ability of the States, and the State of California in particular, to take care of the problem of insolvency and that any action by the Federal government in this are is unnecessary.⁷⁴

(5) AB-1310 was an attempt to protect the claimants of the insolvent company. And (6) insolvency plan had been enacted by other states and "I would hope that California can be added to the

⁷³ibid.

⁷⁴ibid.

list as States that are recognizing this problem."⁷⁵ Another unspoken reason was the potential loss of state revenue.

The general public knew very little of the bill. There was not very much public outcry for any new protection, as was stated earlier. The state's journals paid little attention to the proposed bill, except for in Briggs' own district where, the Fullerton News Tribune ran an editorial on the bill in July of 1969. The article was favorable to the bill. In response to the editorial, Briggs' reply to the paper noted that during the 17 years prior to 1969, only eleven insurance companies were placed in conservatorship or liquidation in California for a total amount of deficiencies of approximately \$5 million. Compared to \$5 billion in premiums in California, this figure said Briggs, was indeed minute. The letter went on to state that there were some insurance companies who were fighting the passage of the bill. However, Briggs was quick to point out that their only contention was whether the bill should be federal or a state law. Those who opposed it believed that it should have been by federal legislation.⁷⁶

The only known opposition to AB-1310 was Gordon Fleury. The rest of the industry was in general agreement. One reason, said a consultant in a letter to the Chairman of the Senate Committee on Insurance and Financial Institutions, probably a major reason, why there was general industry support for the bill was because of

⁷⁵ibid.

⁷⁶ibid.

the bill pending in the U.S. Senate (S. 2236). There was some fear, the consultant said, among the industry of federal encroachment. Fleury's reason, the consultant said, for opposing the bill was that since the Association he represented, the American Insurance Association (AIA) also represented many insurance companies in most of the states, there was a feeling that the federal bill was preferable.⁷⁷

The proposed bill was read on March 27, 1969 and was signed by Governor Reagan on August 31, 1969. There were a few problems with the bill that had to be resolved prior to the bill's final passage. The problems were: (1) Did the assessment on insurers provided for in the bill violate Section 14 4/5 of Article XIII of the State Constitution which provided that the gross premiums' tax in lieu of all other taxes upon such insurers and their property? (2) Did the provisions of Section 127 conflict with the other Insurance Code sections giving the Commissioner authority over the liquidation of insolvent insurers? Which provisions would prevail? (3) The bill excluded from its provisions those insurers writing life insurance. If a company writes both life and other lines of insurance, was it intended to be excluded completely or only to the extent of its life insurance business? (4) If the association is performing state function with respect to the liquidation of insurers, must its employees be civil servants? (5) If the intent was to remove the necessity of assessing the policyholders of Key Insurance Exchange, was there an explicit provision requiring

⁷⁷ibid.

covered claims to be paid by the Guaranty Association prior to an assessment of the reciprocal's policyholders? Is the right of assessment of the policyholders an asset of Key's and its creditors which must be collected prior to assessments of the insurers to pay any deficit? (6) If by this measure the necessity for assessments on policyholders of reciprocal insurers was eliminated, why was not the formation of such assessable insurers prohibited in the future? The one reason it was easier to form them that it was a stock insurer is because their policies are assessable, thus adding the increased financial protection afforded by the assets of policyholders.⁷⁸

The bill was read three times in the Assembly and in the Senate after amendments were made to solve the problems above. There was also an urgency clause attached to the bill. The urgency clause, which required a 2/3rds vote to pass, was adopted after the second reading in the assembly.

Since August 31, 1969 CIGA has played an important role in the regulation of the insurance industry in California.

The Journal of American Insurance, in December of 1970, read

One frequent argument for federal programs is that the states can't or won't meet their rightful responsibilities. That's what some critics said about the problem of insurance company insolvencies a few months ago. But they were wrong.⁷⁹

Since the first of the year, reported the article, 19 states had passed post-insolvency legislation. In all, 29 states,

⁷⁸ibid.

⁷⁹"The States are closing the solvency gap," The Journal of American Insurance, (Nov-Dec 1970) Vol. 46, No. 5, p. 19.

representing about 60 percent of all property-casualty insurance in force in this country, had acted to provide one form or another of this consumer protection. The U.S. Congress did not act on S 2236 before the 91st Congress adjourned January 2. In the spring of 1970 President Nixon sent a new insolvency bill to Congress. The bill was designed to meet the need for prompt legislation without preempting state regulation of insurer insolvencies. Under this bill a mini-Federal agency would have been established to conduct a purely supervisory operation, but it was not adopted.⁸⁰

The performance of California Insurance Guarantee Association has been exemplary in view of the insolvencies it has handled. There have been three major insolvencies in the past decade that cost millions of dollars, most of which were paid by policyholders via a 1/2 to 1 percent tax on every insurance policy. This cost of doing business tax was put on the policyholders to let them know where their money went to. The tax has just been reduced to 1/2 percent. The insolvencies were paid off promptly and effectively.

Recently, Congress has once again entered debate on insurance company insolvency. The current debate concerns regulation prior to the insolvencies. Failed Promises, Insurance Company Insolvencies, (referred to as the Dingell Report,) a February 1990 report by the Subcommittee on Oversight and Investigations, attacked the states' regulatory commissions and their handling of assessing companies before they became insolvent. Other than this, CIGA has done what it was set out to do. In the view of CIGA's

⁸⁰"Nixon Administration offers new approach to insolvency bill," The National Underwriter, February 13, 1970, p. 1.

executive director, who did not want to pat himself on his back too hard, it has done it extremely well.⁸¹

Richard, Richards, Insurance Commissioner, telephone interview, May 1991.

Richard, Richards, "Notes on Assembly Bill No. 1310 (Briggs)," 1987.

California Insurance Code 1989 Edition, California Insurance Guaranty Association.

Congressional Quarterly Almanac, (Washington D.C.), Vol. XX/II, 1969, 1970.

Index of Public General Bills and Resolutions, 91st Congress 1st Session.

Failed Promises, Insurance Company Insolvencies, A Report by the Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce U.S. House of Representatives, U.S. Government Printing Office, (Washington) February 1990.

Gates, John, Executive Director of CIGA, telephone interview, May 1991.

Hearings before the Committee on Commerce United States Senate Ninety-First Congress First Session on S 2236., U.S. Government Printing Office, 1970.

Journal of American Insurance, Vol. 46 No. 5, Sept-Oct 1969, Jan-Feb 1970, Nov-Dec 1970.

Journal of the State Bar of California, "California Insurance Guaranty Association," July-August 1970.

Kimball, Spencer L., Insurance, Government, and Social Policy, (Homewood: Richard D. Irwin) 1969.

National Underwriter, Vol. 74, No. 5, 1969-1970.

Preston, Herbert R., "Insolvencies: A proper perspective," Journal of Insurance Information, Vol. XXVIII, No. 5, Sept- Oct 1967.

⁸¹John Gates, Executive Director of CIGA (1991); telephone interview, (May 1991).

Bibliography

Barger, Richards, Insurance Commissioner, telephone interview, May 1991.

Barger, Richards, "Notes on Assembly Bill No. 1310 (Briggs)," 1969.

California Insurance Code 1989 Edition, California Insurance Guarantee Association.

Congressional Quarterly Almanac, (Washington D.C.), Vol XXVII, No.48, 1969, 1970.

Digest of Public General Bills and Resolutions, 91st Congress 1st Session.

Failed Promises, Insurance Company Insolvencies, A Report by the Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce U.S. House of Representatives, U.S. Government Printing Office, (Washington) February 1990.

Gates, John, Executive Director of CIGA, telephone interview, May 1991.

Hearings before the Committee on Commerce United States Senate Ninety-First Congress First Session on S 2236., U.S. Government Printing Office, 1970.

Journal of American Insurance, Vol. 46 No. 5, Sept-Oct 1969, Jan-Feb 1970, Nov-Dec 1970.

Journal of the State Bar of California, "California Insurance Guarantee Association," July-August 1970.

Kimball, Spencer L., Insurance, Government, and Social Policy, (Homewood: Richard D. Irwin) 1969.

National Underwriter, Vol. 74, No. 5, 1969-1970.

Preston, Herbert R., "Insolvencies: A proper perspective," Journal of Insurance Information, Vol. XXVIII, No. 5, Sept- Oct 1967.