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## CHAPTER 7

# Title V and the Creeping Federalization of Insurance Regulation

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A quick reading of Dodd–Frank—if such a thing is possible—would lead one to conclude that the insurance industry got a pass. Dodd–Frank introduced a new consumer financial products regulator, created a council of regulators to monitor the financial system, devised a comprehensive regulatory structure for derivatives, and generally expanded regulators’ discretionary authority over the financial sector. Dodd–Frank did not explicitly remake the insurance regulatory framework. The McCarran–Ferguson Act’s assurance that insurance is primarily the province of state regulation remains the law.<sup>1</sup>

Nevertheless, Dodd–Frank, perhaps inadvertently, paves the way for federalization of insurance regulation. In doing so, it conflicts with the spirit of McCarran–Ferguson by allowing non-insurance laws to override state insurance regimes. The expanding federal role in insurance regulation is likely to gradually undermine state regulation and fuel an expectation of a federal backstop, which will only serve to heighten calls for increased federal oversight of the industry. This chapter examines each Dodd–Frank contributor to the federalization of insurance, with particular emphasis on Title V, Dodd–Frank’s often-ignored insurance title. The chapter concludes with a brief sketch of possible alternatives to Dodd–Frank’s haphazard federalization approach.

### DODD–FRANK’S FEDERALIZATION OF INSURANCE REGULATION

The federal government was not entirely absent from insurance regulation before Dodd–Frank,<sup>2</sup> but the act markedly increased the federal presence and opened the door to an even greater presence in the future. The dramatic downfall and federal bailout of the insurance giant American International Group (AIG) serves for some as a justification for a more

active federal role in overseeing insurance companies.<sup>3</sup> Proponents of state regulation contend that AIG’s failure was not related to insurance, a claim that glosses over AIG’s life insurance subsidiaries’ troubles.<sup>4</sup> Yet, even if one concedes that the insurance sector was caught up in the crisis, Dodd–Frank could make matters worse by layering an awkward, arbitrary, and costly federal framework on top of the existing state framework.

While this chapter’s main emphasis is on the federalization of insurance regulation that has and likely will continue to occur under Title V of Dodd–Frank, federalization is occurring through four Dodd–Frank routes:

**Title I.** First, Title I of Dodd–Frank created the Financial Stability Oversight Council (FSOC) to monitor and manage risk across the financial system, including in the insurance sector. Title I views certain financial companies and activities as potential threats to financial stability and creates the FSOC to monitor and keep in check those firms and activities. The FSOC’s members include the heads of the federal financial regulators and other relevant experts, including the director of the new Federal Insurance Office, a state insurance commissioner, and an

“independent member appointed by the President with the advice and consent of the Senate, having insurance expertise.”<sup>5</sup> Of these three insurance representatives, only the independent insurance expert has voting power. The presence of three insurance members underscores that Dodd–Frank’s drafters saw insurance firms and activities as well within the FSOC’s purview.

Among the FSOC’s tools for managing systemic risk—which is difficult to define and harder to measure—is the power to designate systemically important companies—including insurers. The Board of Governors of the Federal Reserve System, in consultation with the FSOC, has broad authority to develop tailored prudential standards for designated companies, including liquidity, risk management, and disclosure requirements.<sup>6</sup> These prudential standards must be “more stringent than the standards and requirements applicable to” their purportedly less risky competitors.<sup>7</sup>

The systemic risk associated with insurers—especially life insurers—has been a matter of lively academic debate, particularly in the wake of the problems suffered by AIG and several other large insurance companies during the financial crisis.<sup>8</sup> The FSOC has weighed in on this debate by designating three large insurers—AIG, Prudential, and MetLife—as systemically important and in need of special regulation by the Federal Reserve.<sup>9</sup> The statute directs the FSOC to designate a nonbank financial company systemically important if the FSOC “determines that material financial distress at the... company, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the [company’s activities] *could* pose a threat to the financial stability of the United States.”<sup>10</sup> (Emphasis added.) The statute further directs the FSOC to look at a broad range of issues through a multi-step process in deciding whether to designate a company as needing special regulation by the Federal Reserve. By using “could” and providing the FSOC with an open-ended list of factors to consider, Dodd–Frank affords the FSOC broad designation power.<sup>11</sup> To justify the insurer designations, the FSOC patched together complex failure scenarios from an unrealistic bundle of assumptions about the insurance industry, state insurance regulators, and the designated companies.<sup>12</sup> Prudential and MetLife publicly challenged the FSOC’s systemic determination, and MetLife is engaged in an ongoing lawsuit to overturn its designation.<sup>13</sup>

Regardless of how that lawsuit turns out, the initial insurer designations have begun to take effect. Insurance companies, counterparties, and consumers now operate with added uncertainty because of the FSOC’s power to designate companies and activities. The Federal Reserve already has a powerful place in the insurance regulatory landscape. The extra regulatory costs associated with designation are driving strategic decision making.<sup>14</sup> These costs could increase as the Federal Reserve further determines how it will exercise its regulatory authority over designated insurance companies. FSOC designations also affect non-designated companies, which now face rivals that are earmarked as being too important to fail. For insurance companies that market their longevity and reliability, such a designation could be a real competitive advantage.<sup>15</sup> Thus, Title I embodies a substantial step toward the federalization of insurance regulation, without a clear benefit.<sup>16</sup>

**Title II.** The second Dodd–Frank path toward federalization of insurance regulation is Title II, which establishes a non-bankruptcy mechanism for resolving financial companies identified as systemically risky by the Treasury Secretary and the Federal Reserve in consultation with the President and relevant federal regulators.<sup>17</sup> Insurance companies and insurance holding companies are among the financial institutions that can be identified for resolution under Title II.<sup>18</sup> The Federal Deposit Insurance Corporation (FDIC) serves as receiver for companies selected for resolution under Title II. For insurance companies, however, once a systemic-risk determination is made, Dodd–Frank allows the state law resolution mechanisms to operate (except for the company’s non-insurance subsidiaries and affiliates).<sup>19</sup> If state regulators fail to act within 60 days of the systemic-risk determination, Title II allows the FDIC to step in to resolve the affected insurance company under state law.<sup>20</sup>

The federal government has not yet invoked Title II, but Dodd–Frank raises the possibility of federal involvement in traditional state functions of identifying and resolving failing insurance companies. States manage insurer failures through state receivership proceedings in which the state insurance commissioner typically serves as receiver, and nonprofit guaranty associations established under state law ensure a statutorily established minimum recovery for policyholders.<sup>21</sup> When multistate insurers fail, state guaranty associations coordinate their actions through a national association of guaranty

associations. The government’s potential to intervene in this process adds a measure of uncertainty to the regulatory landscape for large insurance companies, their customers, and counterparties.

**Titles III and VI.** The third route toward greater federal control over insurance comes through Titles III and VI of Dodd–Frank. Title III transferred to the Federal Reserve the now-defunct Office of Thrift Supervision’s (OTS’s) authority over savings-and-loan holding companies (SLHCs).<sup>22</sup> Because many insurance companies—particularly large ones—owned thrifts at the time Dodd–Frank took effect,<sup>23</sup> the law made the Federal Reserve an important insurance supervisor. The Federal Reserve, through its authority over FSOC-designated insurers and insurer SLHCs, oversees approximately one-third of the insurance industry.<sup>24</sup>

Title VI of Dodd–Frank gives the Federal Reserve broad supervisory authority over SLHCs and their subsidiaries. The Federal Reserve may obtain reports from SLHCs and their subsidiaries and examine them to gain information about “the nature of the operations and financial conditions”; “financial, operational, and other risks” that might threaten an insured depository within the holding company or “the stability of the financial system of the United States”; and “systems...for monitoring and controlling [these] risks.”<sup>25</sup> Although Dodd–Frank directs the Federal Reserve to rely on the reports of, and coordinate with, other regulators, the degree to which it does so is up to its own discretion.<sup>26</sup> Dodd–Frank requires the Federal Reserve to examine SLHC non-thrift subsidiaries’ activities “in the same manner, subject to the same standards, and with the same frequency as would be required” for the thrift’s activities.<sup>27</sup> Activities conducted by insurance subsidiaries are excluded, but certain non-insurance activities conducted by insurers may still be covered by this requirement.<sup>28</sup>

The Federal Reserve exercises its holding company authority with the objectives of “protecting the safety and soundness of the consolidated firms and their subsidiary depository institutions while mitigating any risks to financial stability.”<sup>29</sup> In practice, those objectives translate into substantial control over insurers, and the Federal Reserve plans to use its holding company authority more aggressively than its predecessor, the OTS.<sup>30</sup> The Federal Reserve plans “to establish an SLHC supervisory program similar in nature to its long-established supervisory program for bank holding companies.”<sup>31</sup> In its new

supervisory capacity, the Federal Reserve is working on matters, such as developing capital requirements, subjecting regulated companies to stress tests, and setting risk-management and corporate-governance standards.<sup>32</sup> The Federal Reserve does not have extensive insurance expertise.<sup>33</sup> As a consequence, its tendency is likely to be to approach matters from its traditional bank regulatory perspective.

As a major insurance supervisor, the Federal Reserve participates in the global standard-setting deliberations of the International Association of Insurance Supervisors (IAIS) and the Financial Stability Board (FSB).<sup>34</sup> The Federal Reserve may not be of one mind with state regulators in international regulatory dialogues. The Federal Reserve insists that its regulatory interests are “complementary to, and coordinated with, state insurance regulation,”<sup>35</sup> but Paul Kupiec has identified potential “serious conflicts” between state insurance regulations and “new Federal Reserve examination and capital policies for insurers affiliated with a depository institution.”<sup>36</sup>

**Title V.** The final insurance-related piece of Dodd–Frank—Title V, although innocuous at first glance—makes it unlikely that any aspect of insurance regulation is beyond the reach of federal regulators. Title V creates a new Federal Insurance Office (FIO). The FIO is not a front-line regulator, but it may become a backdoor regulator. On the one hand, the FIO brings insurance expertise to the federal government, something that has been lacking at the federal level.<sup>37</sup> On the other hand, although limited in apparent reach, Title V lays the groundwork for a larger future role for the federal government in insurance regulation. The potential role of the FIO in expanding federal insurance regulation is the subject of the next section.

## THE ROLE OF THE FIO IN EXPANDING FEDERAL REGULATION

Title V of Dodd–Frank—the “Federal Insurance Office Act of 2010”—creates the Federal Insurance Office, an office within Treasury. The FIO’s mandate includes all insurance except medical, long-term care, and federal crop insurance.<sup>38</sup> The office acts “pursuant to the direction of the Secretary.”<sup>39</sup> The Treasury Secretary appoints the FIO director, but has limited ability to remove him from the position.<sup>40</sup> Dodd–Frank authorizes the FIO director—in carrying out its functions—to consult with state regulators, but the extent of that consultation is left to the director’s discretion.<sup>41</sup> Dodd–Frank disclaims

any intention of making the FIO an insurance regulator or supervisor,<sup>42</sup> and the FIO, too, disclaims such a role.<sup>43</sup> Nevertheless, the FIO establishes a federal presence in the insurance industry. As Patricia McCoy points out, by bringing insurance experts into the federal government, the FIO makes a more active federal role in insurance likely.<sup>44</sup>

**Functions of the FIO.** The FIO plays an important role in influencing domestic and international insurance policy. The FIO director advises the Treasury secretary “on major domestic and prudential international insurance policy issues.”<sup>45</sup> The FIO is charged with seven broad responsibilities: (1) monitoring the insurance industry,<sup>46</sup> including identifying systemically consequential regulatory gaps; (2) monitoring “access to affordable insurance products” for “traditionally underserved communities and consumers, minorities...and low- and moderate-income persons”; (3) recommending insurers for FSOC designation; (4) helping to administer the Terrorism Insurance Program; (4) playing a lead role in international insurance discussions and negotiations; (5) determining whether state regulations are pre-empted by international prudential regulatory agreements; (6) consulting with states on national and international issues; and (7) carrying out “other related duties and authorities as may be assigned” by the Treasury Secretary.<sup>47</sup>

The FIO has a number of powers, which offer it substantial ability to affect the financial landscape. The FIO may collect information from insurers<sup>48</sup> and their affiliates,<sup>49</sup> “enter into information-sharing agreements”; “analyze and disseminate” the information it collects; and issue reports.<sup>50</sup> Dodd-Frank does not meaningfully limit the data that the FIO can collect. “Small” insurers are exempt from data collection, but the FIO determines what “small” means.<sup>51</sup> Although Dodd-Frank requires the FIO to see if it can obtain the information in a timely manner from federal and state insurance regulators before collecting the information itself, the statute empowers the director to collect the information directly if he determines that the other regulator cannot provide the information on time.<sup>52</sup>

Dodd-Frank provides the director with subpoena power to get the information—a power limited only by the requirement that he make a written finding that the FIO needs the information and has worked with other regulators to get it.<sup>53</sup> Because affiliates of insurance companies are covered, the range of companies subject to this subpoena power

is quite broad. Depending on the breadth and timing of the demands, such data requests could be extremely burdensome. The power to disseminate the information it collects may give the FIO leverage with other regulatory bodies, including state regulators, which may want access to the information.<sup>54</sup> The dissemination power also might give the FIO power to exert a substantive influence over insurers’ activities; an insurer might cease engaging in certain activities—such as risk-based pricing—if the company knows that the FIO plans to disclose the information. Nonpublic information is protected under the statute.<sup>55</sup>

The FIO plays a role in extending systemic regulation to insurance companies. The FIO’s director serves as a nonvoting “advisory” member of the FSOC.<sup>56</sup> In that capacity, the FIO director has acceded to the insurance company designations under Title I of Dodd-Frank. Dodd-Frank also gives the FIO a coordinating role in the Federal Reserve’s stress testing of designated insurers.<sup>57</sup> Under Title II of Dodd-Frank, the director, along with two-thirds of the Federal Reserve’s Board of Governors, can recommend that the Treasury Secretary make a systemic-risk determination with respect to an insurance company, or a company the largest subsidiary of which is an insurer.<sup>58</sup> The Treasury Secretary can initiate the process by which the FIO and the board consider whether to make a recommendation, but absent a recommendation, the Secretary cannot make the designation.<sup>59</sup> The right to assent to or block a determination is a significant power for the FIO director.

As developer of “Federal policy on prudential aspects of international insurance matters,”<sup>60</sup> the FIO’s role in international discussions is also important. Under Dodd-Frank, the FIO represents the United States at the IAIS, an organization of 200 insurance regulators focused on fostering consistent regulation and financial stability.<sup>61</sup> At the IAIS, the FIO serves on the Executive and Financial Stability Committees and chairs the Technical Committee.<sup>62</sup> In these capacities, the FIO is involved in discussions of great importance to the insurance industry, including methods for identifying global systemically important insurers, the initiative to establish common standards for the supervision of internationally active insurance groups (Com-Frame), equivalency determinations under Europe’s Solvency II, and capital requirements for large insurers.<sup>63</sup> The FIO could use international negotiations to advocate regulatory approaches that are

dependent on consolidated supervision and uniform national standards, which may be easiest to achieve through federal regulation. Thus, the FIO's international work could help to shift the balance of regulatory power in the U.S.

The FIO is able to influence state insurance regulation by using its platform as in-house insurance expert for the federal government, representing the U.S. in international insurance discussions, exercising its information-collection and dissemination powers, and engaging in systemic regulation discussions pertaining to insurance companies. Of particular importance, however, is the FIO's pre-emption power.

**FIO Pre-emption Power.** Dodd–Frank allows the FIO director to pre-empt certain state insurance laws and regulations. Specifically, the FIO may pre-empt prudential state insurance laws and regulations that are inconsistent with an internationally negotiated covered agreement,<sup>64</sup> and disadvantage insurance companies domiciled in foreign countries that are part of the agreement.<sup>65</sup> Covered agreements relate to equivalency determinations about prudential regulation of insurance or reinsurance.<sup>66</sup> The FIO is not authorized to pre-empt state measures governing “rates, premiums, underwriting, or sales practices”; “coverage requirements”; or state antitrust law and may not disturb Title X of Dodd–Frank, which created the Bureau of Consumer Financial Protection.<sup>67</sup> Thus, pre-emption is excluded in areas in which some have argued the federal government could play a positive role in paring back excessive regulation.<sup>68</sup>

In November 2015, the Treasury Secretary and the U.S. Trade Representative informed Congress of their intent to open covered agreement negotiations with the European Union.<sup>69</sup> The stated objectives of the negotiations are (1) an equivalency determination by the EU for the U.S.; (2) EU recognition of the mixed state-federal insurance regulatory system; (3) facilitation of regulators' cross-border information exchange; (4) “nationally uniform treatment of EU-based reinsurers operating in the United States, including with respect to collateral requirements”; and (5) EU recognition of the equivalency of U.S. insurance and reinsurance solvency regimes.<sup>70</sup> The Administration promised to allow state insurance regulators to play “a meaningful role during the covered agreement negotiating process.”<sup>71</sup> State insurance regulators, however, do not have a legislatively guaranteed seat at the table in this or any other covered agreement negotiation. The FIO is likely to use

its pre-emption powers in connection with the fifth objective to override state reinsurance collateral regulations, which has already engendered concerns among state regulators.<sup>72</sup>

The pre-emption process is unlikely to be used frequently because it is cumbersome. Once a covered agreement is in place, to effect a pre-emption, the FIO must notify the affected state and the U.S. Trade Representative and publish a notice and request for comment in the *Federal Register*.<sup>73</sup> If the director decides to proceed with the pre-emption, he must notify the state and Congress, and allow at least 30 days for the pre-emption to take effect so that the state can take action to eliminate the need for pre-emption.<sup>74</sup> After pre-emption, consumers must be protected in a “substantially equivalent” manner to that afforded by the pre-empted state measure.<sup>75</sup> The FIO pre-emption determinations are subject to the Administrative Procedure Act and *de novo* judicial review.<sup>76</sup> Despite these procedural protections, the pre-emption power is nevertheless a substantial power for a federal government official to wield unilaterally. Moreover, although the pre-emption power is now limited to matters implicating covered agreements, it could expand over time.<sup>77</sup>

**The FIO and Future Federalization.** On balance, the FIO seems to envision further federalization in the future. One of the FIO's major initial projects was a report to Congress “on how to modernize and improve the system of insurance regulation in the United States.”<sup>78</sup> Among the topics for consideration were the merits and drawbacks of federal insurance regulation.<sup>79</sup> While the modernization report handles the federalization issue delicately, read as a whole, the report raises the possibility that federalization and the FIO role will grow over time.

Generally, although the modernization report highlights potential benefits from federalization, it does not answer the federalization question definitively.<sup>80</sup> The FIO points out that federal insurance regulation could lower costs for insurance companies and their consumers and provide uniformity, which, in turn, would facilitate oversight and international negotiations and reduce opportunities for regulatory arbitrage.<sup>81</sup> The report balances these points with the lukewarm concession that the “limitations inherent in a state-based system of insurance regulation, however, do not necessarily imply that the ideal solution would be for the federal government to displace state regulation *completely*.”<sup>82</sup> (Emphasis added.) After all, the report continues,

insurance products have a local character, and creating a federal insurance regulator would be “a significant undertaking.”<sup>83</sup>

The FIO modernization report identifies a role for the federal government in some areas. The report calls for immediate federal involvement in several areas, including federal standards for mortgage insurers,<sup>84</sup> and FIO participation in supervisory colleges for national and international insurers.<sup>85</sup> The FIO contends that its participation in supervisory colleges would “not only strengthen the U.S. system of insurance regulation but also support the global credibility of the U.S. insurance industry.”<sup>86</sup> The FIO’s direct, insurer-specific engagement with insurance supervisors also would give the FIO a quasi-regulatory role, which is a substantial step toward federalized insurance supervision.<sup>87</sup> The FIO also has suggested a possible federal role in the consolidated supervision of global insurers.<sup>88</sup>

The FIO attempts—in the modernization report and otherwise—to nudge state insurance policy toward greater national uniformity and toward achieving policy objectives favored by the FIO. The FIO can offer a valuable outside perspective on state insurance policy,<sup>89</sup> but its recommendations could subtly displace state regulators’ independent decision making. The FIO’s recommendations may not be superior to state regulators’ decisions, particularly because the FIO is not accountable to policyholders.<sup>90</sup> The FIO modernization report recommends that states take particular actions, including imposing character and fitness requirements on insurers’ officers and directors and adopting the NAIC’s model suitability regulation for annuity transactions.<sup>91</sup> The FIO’s 2015 annual report notes the slow adoption of the model standard since the modernization report’s publication and suggests “[i]n the absence of more uniform adoption and implementation of the Model Suitability Regulation, federal authorities should consider appropriate action.”<sup>92</sup> In the annual report, FIO “encourages state insurance regulators to assess the current [risk-based capital] approach and explore appropriate ways to increase incentives for infrastructure investments by insurers, an objective consistent with the Administration’s broader support for infrastructure investment.”<sup>93</sup> It also urges state regulators to “assess whether marital status is an appropriate underwriting or rating consideration” or whether it unfairly penalizes “consumers [who] opt not to marry, or are divorced or widowed.”<sup>94</sup>

The annual report similarly asks state regulators to reconsider allowing automobile insurers to use gender as an underwriting criterion, particularly given complexities associated with gender identity.<sup>95</sup> In the area of cybersecurity, the FIO recommends that state regulators “develop, adopt and uniformly implement examination standards for insurer cyber security that are consistent across all states and which comply with best practices for oversight of financial institutions.”<sup>96</sup>

Although not mandates, these recommendations relate to areas previously secured in the province of states. Moreover, the FIO suggests future federal involvement if the states do not conform to the recommendations.<sup>97</sup> The FIO can also influence state regulation through its collaboration with state regulators on pilot programs related to reforms of rate regulation.<sup>98</sup>

Once a bureaucracy is established, its tendency is to expand,<sup>99</sup> and the FIO has identified a number of areas in which it might expand. As it identifies areas in which states are falling short, the FIO is likely to seek a more active role for itself in shaping insurance policy.

## OTHER COMPONENTS OF TITLE V

In addition to creating the FIO, Title V addresses surplus lines (also known as non-admitted insurance) and reinsurance. Surplus lines enable customers to obtain coverage “for risks that are not adequately insured by insurers licensed to do business” in their state, and may cover property in more than one state.<sup>100</sup> Dodd–Frank sought to streamline and bring uniformity to the taxation, regulation, purchase, and broker licensing in connection with surplus line insurance.<sup>101</sup> As of December 2013, according to the FIO, “states have not fulfilled this vision.”<sup>102</sup> Title V likewise tried to rationalize the regulation of reinsurance by placing (1) regulatory responsibility over reinsurance contracts and the decision of whether to credit reinsurance with the home state of the insurer purchasing the reinsurance and (2) sole regulatory responsibility for a reinsurer’s financial stability with the home state of the reinsurer.<sup>103</sup> These provisions apply only to NAIC-accredited states or those with “substantially similar” requirements.<sup>104</sup>

The purpose of these sections of Dodd–Frank is to provide certainty and consistency in areas where there has been confusion. Although these provisions leave some implementation questions unanswered, they have begun the process of resolving long-standing jurisdictional conflicts. Repealing them would

reintroduce uncertainty. In fact, these provisions could be supplemented by additional efforts to bring certainty to insurance regulation, a subject that the next sections will discuss.

## CURRENT SYSTEM OF STATE-BASED REGULATION

Insurance regulation has historically relied on separate regulatory infrastructures in each state, but coordination among states has increased over time. State insurance regulation may include requirements such as licensing, adherence to solvency standards, pre-approval of form and rate changes, and compliance with underwriting and rate-setting limitations and market conduct standards.<sup>105</sup> State regulators monitor solvency through a system of risk-based capital.<sup>106</sup> One state typically takes the lead in monitoring an insurer's financial status. If there is an insolvency, policyholders are protected through state guaranty funds administered by nonprofit, state-level, insurance-line-specific entities that are typically funded by ex-post assessments on other insurance companies licensed in the state.<sup>107</sup> State insurance regulators have developed a deep expertise in insurance regulation and have increasingly worked with one another through the NAIC and supervisory colleges to improve insurance regulation nationwide.

The state-based insurance regulatory system poses a number of difficulties. Insurance companies, unlike other financial services companies operating across state lines, must be licensed in each state in which they operate.<sup>108</sup> The duplication of regulatory effort and prescriptive nature of regulation translates into higher prices and fewer product offerings for, and less responsiveness to, consumers.<sup>109</sup> It is not clear that consumers benefit.<sup>110</sup> Does a consumer really need her insurance company and its products to be approved by a regulator in her own state? Would she be better off if she also had access to insurers and products regulated elsewhere? State regulation serves as a barrier to competition.<sup>111</sup> Moreover, the lack of a single voice in insurance has made U.S. participation in international insurance discussions difficult.<sup>112</sup> State regulators—along with their federal counterparts—do not have an impeccable track record.<sup>113</sup>

Efforts at increasing national uniformity, making international negotiations easier, and lowering barriers to entry and duplication of effort have had mixed success in the context of the state-based system. The NAIC, which has existed for nearly a

century and a half, brings state insurance regulators together to address issues of common concern, facilitate information sharing, promulgate best-practice standards and model laws, provide training, and coordinate supervisory efforts.<sup>114</sup> Often prompted by the threat of federal action, the NAIC has increased uniformity across and cooperation among states.<sup>115</sup> States, however, retain their independent legislative and regulatory authority and are free to ignore NAIC recommendations and standards.<sup>116</sup>

As the next section will show, Dodd–Frank does not offer an effective answer to the problems associated with state-based insurance regulation.

## ALTERNATIVES TO DODD-FRANK'S BACKDOOR FEDERALIZATION

For years there has been a vibrant debate about what role federal regulators should play in insurance regulation. Participants in the debate have highlighted the costs and benefits associated with a greater federal role.<sup>117</sup> Calls for more federalization have been driven by concerns about the expense and inefficiency of state regulation, a belief that a national insurance market needs a national regulator, the failures of state regulators, the need for a consistent international voice in insurance regulation, and—most recently—financial stability concerns.<sup>118</sup> Others have argued that the state regulatory system works well and should remain intact.<sup>119</sup> Dodd–Frank complicates the debate by increasing federalization without definitively embracing it.

Dodd–Frank retains the state-by-state system, but adds a layer of federal regulation. This system preserves problematic aspects of state regulation; adds uncertainty through the FSOC's designation powers; gives substantial supervisory power over insurance to the inexperienced and overextended Federal Reserve; and, in the FIO, creates a foothold and an advocate for an increasing federal role in insurance regulation. As one industry observer said of pre-Dodd–Frank efforts to federalize undesirable parts of state regulation, “[t]hat insidious approach to a patchwork system of shared regulation, unfettered by serious regulatory policy discussion, is probably the worst of all possible alternatives.”<sup>120</sup> Dodd–Frank has added new complexities, uncertainties, and redundancies by charging federal regulators with operating alongside—and sometimes in competition with—the existing state regulatory system.

Rather than continue with the post-Dodd–Frank hybrid, policymakers may want to take a more

comprehensive look at insurance regulation. Two alternatives are described briefly below, but these and other options warrant more careful consideration as part of an effort to improve the effectiveness and efficiency of insurance regulation.

**Federal Charter Alternative to Backdoor Federalization.** One alternative to Dodd–Frank’s backdoor federalization is an explicit embrace of federal regulation through the adoption of a federal chartering regime for insurance companies. Insurance companies chartered at the federal level would be able to offer insurance products in any state. A conscious decision for a federalized insurance regulatory regime—as opposed to Dodd–Frank’s indirect embrace of a federalized scheme—would require policymakers to engage in careful deliberation about the many difficult issues associated with transitioning to and operating a federal system.

Federal chartering could be optional for all insurance companies or mandatory for a subset. Federal chartering has long been a topic of discussion in policy circles.<sup>121</sup> Many view it as an opportunity to modernize insurance regulation and improve its efficiency and efficacy.<sup>122</sup> Advocates contend that a federal charter would be more appropriate than a state charter for nationally and internationally active insurance companies.<sup>123</sup> They maintain that insurance companies are at a competitive disadvantage because other financial services companies, such as banks, can avail themselves of a federal charter and federal pre-emption.<sup>124</sup> Optional federal chartering, based on the bank regulatory model, would give insurers the choice of a state or federal license.<sup>125</sup> A *mandatory* federal charter for insurance companies operating in multiple states is an alternative approach that would ensure that the federal government exercised regulatory authority over multistate insurers—a more predictable alternative to the unevenly applied FSOC designations.

A federal insurance regulator could bring uniformity, consolidated supervision, and cost reductions for insurers and their customers. A dedicated federal regulator could also facilitate U.S. insurers’ functioning in the international marketplace. The federal charter therefore would effectively address financial stability concerns and provide a single national voice in international insurance discussions. Policymakers would have to rethink the role that state guaranty funds would play in a federal system. One cost to be weighed in connection with

federal regulation is the inevitable pressure for an accompanying federal guaranty.<sup>126</sup>

If the federal charter route were chosen, the FIO could be converted into a politically balanced independent insurance commission outside the Treasury.<sup>127</sup> Its members would be presidentially nominated and Senate-confirmed. It could charter, regulate, and supervise insurers. Removing the Federal Reserve’s powers over insurance SLHCs and FSOC-designated insurers would be a necessary complement to a federal charter approach in order to avoid duplicative federal effort.<sup>128</sup> The federal approach would leave the state system intact, as many insurance companies would not be covered by the federal regime.

**State-Based Competitive Approach to Insurance Regulation.** A different alternative to Dodd–Frank’s uncomfortable mix of state and federal regulation would be a state-centric approach that allows an insurer chartered, regulated, and supervised by one state to provide insurance in any other state. There is no reason to assume that federal regulators will be better at insurance regulation than their more experienced state counterparts.<sup>129</sup> A state-centric approach also would erode the expectations of federal bailouts of insurance companies, which accompany federal regulatory regimes.<sup>130</sup> Moreover, as Professors Martin Grace and Robert Klein point out, “the scope and design of insurance regulatory policies is probably more important than whether authority resides with the federal government or with the various states.”<sup>131</sup> Accordingly, instead of building a new federal regulator, this approach would rely on existing regulators.

A state regulatory approach could be based on a proposal made by Professors Henry Butler and Larry Ribstein.<sup>132</sup> Specifically, Butler and Ribstein would allow insurance companies to choose a state regulator and the law that would govern their insurance policies: “Insurers would get a single state charter under which they could do business everywhere. That state would both regulate solvency and provide the relevant guaranty fund.”<sup>133</sup> Professor Scott Harrington similarly has suggested “allow[ing] insurers to choose a ‘primary state’ for the purpose of rate, form, and possibly a number of other types of regulation and allow them to operate in all other states where they are licensed (‘secondary states’) without having to meet the corresponding requirements in those states.”<sup>134</sup>

The state-based competition approach has precedent. States compete based on the quality of their laws for corporate charters.<sup>135</sup> A single state-based

licensing model also has precedent in the European passport approach, which allows companies licensed in one European country to operate in others.<sup>136</sup>

A state-based system would enable states to try different regulatory methods. The regulatory diversity associated with a state-based model would facilitate comparisons of different approaches, but could also be better from a financial stability perspective. As former insurance regulator Therese Vaughan cautions, “uniformity is efficient, but it can be efficiently and catastrophically wrong.”<sup>137</sup> Under the current system, states guard their profitable insurance regulatory franchises.<sup>138</sup> The new approach would reward states that develop efficient regulatory systems with insurance revenue. The European experience suggests that a state competition model might generate pressure for minimum nationwide standards to ensure that no state was able to woo insurers with a less rigorous regulatory model.<sup>139</sup>

Rather than relying on uniform minimum standards, however, a state-based approach could rely on insurance companies to monitor state regulators. Insurance companies likely would avoid states with costly regulatory regimes, but they would also shy away from cheap, yet ineffective, regimes. Insurers are currently exposed to one another through guaranty funds,<sup>140</sup> and this exposure could be heightened under a state-based model by requiring the guaranty fund of the chartering state to cover all policyholders regardless of where they live,<sup>141</sup> and eliminating the ability that many states afford for insurers to offset guaranty fund contributions against their premium tax bills.<sup>142</sup> Moreover, insurance companies in need of a regulator that will pass muster with foreign countries would press states to develop effective, but reasonable regulatory regimes. As suggested by Ribstein and Butler, a more creative element of the approach could be a requirement that insurance companies “issue solvency bonds that default if the state guaranty fund fails.”<sup>143</sup> Not only would these bonds—the prices of which would reflect market participants’ assessment of the efficacy of the relevant state’s regulatory system—help to push states toward the right level of regulation, they would provide valuable information to the broader market.<sup>144</sup>

Under this state-based approach, the federal presence in insurance regulation could be limited. The FIO could be eliminated, or its powers pared back substantially. The Federal Reserve would shed its insurance supervisory responsibilities. The FSOC’s power to designate insurance companies for Federal

Reserve supervision would be eliminated as coordination issues across multiple state insurance regulators would be minimized. To address the systemic concerns that motivated Dodd–Frank’s designation framework, states could condition a state charter on the ability to monitor and exert some degree of regulatory authority over the actions of an insurer’s affiliates.<sup>145</sup>

## CONCLUSION

Dodd–Frank adds to the complexity of the insurance regulatory framework without enhancing stability or augmenting consumer protection. The statute layers a new federal insurance bureaucracy—comprising the FSOC, the Federal Reserve, and the FIO—on top of the existing state regulatory framework. The FSOC and the Federal Reserve now are important factors in shaping the insurance regulatory landscape. Although the FIO’s powers seem limited at first glance, they offer the federal government a base from which to exert expanding control over insurance regulation. The result is a combination of undesirable features from the pre-existing state insurance regulatory system and the new Dodd–Frank regime. Insurers continue to have to deal with multiple states, and consumers bear the cost of state and federal regulation. The FSOC takes an expansive approach in designating insurers. The Federal Reserve brings little insurance expertise and a bank-centric approach to its increasing role as an insurance regulator. The FIO has authority to pre-empt state law, impose uniform standards of its choosing on states, and subject insurers and their affiliates to additional reporting burdens. The intensified federal presence in insurance regulation is likely to reinforce the expectation in the minds of insurers’ customers and counterparties, which was created by the AIG rescue, that the federal government will step in to rescue an insurer that fails on its watch. Such assumptions are bolstered by Title II of Dodd–Frank.

A better approach would replace Title V’s backdoor federalization either with an open, considered embrace of federal insurance regulation through federal chartering and the creation of a dedicated federal insurance regulator, or with a competitive state-based regulatory model. As the flaws of Dodd–Frank’s mixed approach become more evident, each of these possible alternative approaches merits more extensive analysis by academics and policymakers.

*Any views expressed here are those of the author, not necessarily of The Heritage Foundation.*

## ENDNOTES:

1. See 15 U.S. Code § 1011, which declares “that the continued regulation and taxation by the several States of the business of insurance is in the public interest,” and 15 U.S. Code § 1012(a), which states that the “business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.” The McCarran–Ferguson Act only allows federal law “to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business [if the law] specifically relates to the business of insurance.” 15 U.S. Code § 1012(b).
2. Viral V. Acharya and Mathew Richardson, “Is the Insurance Industry Systemically Risky?” in John H. Biggs and Matthew P. Richardson, eds., *Modernizing Insurance Regulation* (New York: Wiley, 2014), pp. 151–152. As examples of the federal government’s “interven[tion] in states’ insurance regulation,” Acharya and Richardson point to the Employment Retirement Income Security Act’s pre-emption of state regulation, the Securities and Exchange Commission’s regulation of variable annuities and insurers’ financial reporting, the Terrorism Risk Insurance Act, and the federal law that allows risk-retention groups to operate under a single charter.
3. See, for instance, “Brief of Better Markets as Amicus Curiae Supporting Defendant,” *MetLife v. Financial Stability Oversight Council*, No. 15-cv-45, 6, May 22, 2015. Better Markets explains: “AIG’s role in the crisis prompted Congress to give FSOC broad-ranging authority to designate nonbanks—including insurance companies—for enhanced supervision, and to take international activities into account in the process. Notwithstanding the fact that AIG was an insurance conglomerate, with significant overseas operations, it nevertheless played a central role in precipitating a financial crisis of epic magnitude here in the United States.”
4. Arguments that state-regulated insurance companies were not implicated in or affected by AIG’s downfall found a receptive audience among policymakers, but a key aspect of AIG’s downfall was the life insurance subsidiaries’ securities lending activities. See, for instance, Hester Peirce, “Securities Lending and the Untold Story in the Collapse of AIG,” Mercatus Center *Working Paper* No. 14-12, May 2014, [http://mercatus.org/sites/default/files/Peirce\\_SecuritiesLendingAIG\\_v2.pdf](http://mercatus.org/sites/default/files/Peirce_SecuritiesLendingAIG_v2.pdf) (accessed February 12, 2016).
5. Dodd–Frank § 111 (12 U.S. Code § 5321).
6. Dodd–Frank § 165 (12 U.S. Code § 5365).
7. Dodd–Frank § 165(a) (12 U.S. Code § 5365(a)).
8. See, for instance, Acharya and Richardson, “Is the Insurance Industry Systemically Risky?” Based on their empirical analysis, Acharya and Richardson conclude that today’s “insurance sector may be a source for systemic risk,” because it is engaged in nontraditional activities and “(1) offers products with nondiversifiable risk, (2) is more prone to a run, (3) insures against macro-wide events, and (4) has expanded its role in financial markets.” For another view, see J. David Cummins and Mary A. Weiss, “Systemic Risk Regulation of the U.S. Insurance Industry,” in Biggs and Richardson, eds., *Modernizing Insurance Regulation*, pp. 85–135. Cummins and Weiss conclude that insurance companies’ noncore activities and some life-insurance core activities are associated with systemic risk, but that insurers tend to be “victims rather than propagators of systemic risk events.” See also Scott E. Harrington, “Designation and Supervision of Insurance SIFIs,” in Biggs and Richardson, *Modernizing Insurance Regulation*, pp. 139–141. Harrington summarizes the findings of qualitative studies that core insurance activities are not systemic, and raises questions about the accuracy of quantitative measures that implicate insurance companies as systemic risks. See also Anna Paulson et al., *Assessing the Vulnerability of the U.S. Life Insurance Industry* in Biggs and Richardson, eds., *Modernizing Insurance Regulation*. Based on an analysis of the liquidity of life insurance companies’ assets and liabilities, Paulson et al. assess the vulnerability of life insurance companies under different stress scenarios. Finally, see Daniel Schwarcz and Steven L. Schwarcz, “Regulating Systemic Risk in Insurance,” *University of Chicago Law Review*, Vol. 81 (2014), p. 1639. Schwarcz and Schwarcz argue “that insurance-focused financial firms can be systemically risky not only due to their size—which is currently the primary focus of federal regulation in insurance, spurred by AIG’s near failure—but also due to commonalities and correlations in insurance products, investment strategies, risk exposures, risk management, and interconnections to the larger financial system.”
9. All of these insurers have global designations as well. The Federal Reserve has an outsized voice in global insurer designations through its active role on the international Financial Stability Board (FSB), which designates global systemically important financial institutions (G-SIFIs). A follow-on FSOC designation of a G-SIFI is extremely likely. See, for instance, Roy Woodall, “Independent Member Having Insurance Expertise,” FSOC, “Dissenting Views on the FSOC’s Designation of MetLife, Inc.,” December 18, 2014, p. 4. Woodall wrote: “It is clear to me that the consent and agreement by some of the Council’s members at the FSB to identify MetLife a G-SIFI, along with their commitment to use their best efforts to regulate said companies accordingly, sent a strong signal early-on of a predisposition as to the status of MetLife in the U.S.—ahead of the Council’s own decision by all of its members.”
10. Dodd–Frank § 113(a)(1) (12 U.S. Code § 5323(a)(1)).
11. The statute lists 11 considerations, including leverage, regulatory status, and the all-encompassing “any other risk-related factors that the Council deems appropriate.” Dodd–Frank § 113(a)(2) (12 U.S. Code § 5323(a)(2)).

12. For the bases for the determinations, see U.S. Department of the Treasury, “Financial Stability Oversight Council: Designations,” <https://www.treasury.gov/initiatives/fsoc/designations/Pages/default.aspx#nonbank> (accessed January 20, 2016). The FSOC’s independent insurance expert Roy Woodall objected that his colleagues had based MetLife’s designation on an improbable hypothetical, grounded in “stem[ming] from a sudden and unforeseen insolvency of unprecedented scale, of unexplained causation, and without effective regulatory responses or safeguards.” See U.S. Department of the Treasury, “Views of the Council’s Independent Member Having Insurance Expertise,” p. 3, <https://www.treasury.gov/initiatives/fsoc/designations/Documents/Dissenting%20and%20Minority%20Views.pdf> (accessed February 16, 2016). Similarly, John Huff, then the FSOC’s insurance commissioner representative, objected to the FSOC’s designation of Prudential based on “merely speculative outcomes related to the liquidation of assets that are not supported by a sufficient understanding of the heterogeneity of insurance products or insurer asset disposition.” See U.S. Department of the Treasury, “Resolution Approving Final Determination Regarding Prudential Financial, Inc.,” p. 1, <https://www.treasury.gov/initiatives/fsoc/council-meetings/Documents/September%2019%202013%20Notational%20Vote.pdf> (accessed February 16, 2016).
13. MetLife, “Information Regarding MetLife’s SIFI Designation: About the SIFI Designation and Judicial Review,” <https://www.metlife.com/sifiupdate/index.html> (accessed January 18, 2016).
14. Illustrating the Federal Reserve’s influence, MetLife recently announced its intention to spin off a large part of its retail operations. MetLife CEO Steven A. Kandarian explained the move:  
  
Currently, U.S. Retail is part of a Systemically Important Financial Institution (SIFI) and risks higher capital requirements that could put it at a significant competitive disadvantage. Even though we are appealing our SIFI designation in court and do not believe any part of MetLife is systemic, this risk of increased capital requirements contributed to our decision to pursue the separation of the business. An independent company would benefit from greater focus, more flexibility in products and operations, and a reduced capital and compliance burden.  
  
News release, “MetLife Announces Plan to Pursue Separation of U.S. Retail Business,” MetLife, January 12, 2016, <https://www.metlife.com/about/press-room/index.html?compID=192215> (accessed February 16, 2016).
15. See, for instance, Scott E. Harrington, “Designation and Supervision of Insurance SIFIs,” in Biggs and Richardson, eds., *Modernizing Insurance Regulation*, p. 146. Harrington explains that “other things being equal, a SIFI designation could allow a designee to obtain funding at a lower cost and have a competitive advantage in attracting risk-sensitive policyholders.”
16. See chapter 3 in this book (Peter Wallison on Title I) for a more comprehensive critique of systemic-risk designations. Scott Harrington has argued against systemic-risk designations in the insurance context. See, for instance, Scott E. Harrington, “The Financial Crisis, Systemic Risk, and the Future of Insurance Regulation,” *Journal of Risk and Insurance*, Vol. 76 (2009), p. 808. Harrington asks: “What would the Federal Reserve have done differently if it had systemic risk authority [over AIG] before the crisis?” See also Harrington, “Designation and Supervision of Insurance SIFIs,” pp. 143–147. Harrington outlines the potential adverse consequences of designating insurers as systemically important.
17. For the systemic-risk determination process, see Dodd–Frank § 203 (12 U.S. Code § 5383). The statute prescribes a special process, which requires the assent of the Director of the Federal Insurance Office for “cases involving insurance companies.” Dodd–Frank § 203(a)(1)(C) (12 U.S. Code § 5383(a)(1)(C)).
18. Dodd–Frank § 203(a)(1)(C) (12 U.S. Code § 5383(a)(1)(C)) sets forth procedures for selecting insurance companies for orderly liquidation.
19. Dodd–Frank § 203(e)(3) (12 U.S. Code § 5383(e)(3)).
20. Dodd–Frank § 203(e) (12 U.S. Code § 5383(e)).
21. For a discussion on insurance receiverships at the state level and state guaranty associations, see Peter G. Gallanis, “Policyholder Protection in the Wake of the Financial Crisis,” in Biggs and Richardson, eds., *Modernizing Insurance Regulation*, pp. 207–240.
22. Dodd–Frank § 312(b) (12 U.S. Code § 5412(b)).
23. Some insurers sold or converted their thrifts to avoid falling under Federal Reserve supervision. See, for instance, Elizabeth D. Festa and Arthur D. Postal, “Insurers Face New Regulation from Federal Reserve,” LifeHealthPro.com, May 2, 2012. Festa and Postal report: “Some of the companies on the Fed’s list are already either shedding their operations, or are planning to do so out of a concern of facing an additional layer of regulation through the Fed.” See also Young Ha, “W.R. Berkley Corp. Divests, Connecticut Bank Acquires InsurBanc,” *Insurance Journal*, April 22, 2013, <http://www.insurancejournal.com/magazines/features/2013/04/22/288675.htm> (accessed February 17, 2016). Ha reports: “W.R. Berkley said in its SEC filing that to avoid adverse consequences of enhanced restrictions, the board decided to divest its banking operations so that it could deregister as a savings and loan holding company.”
24. Mark E. Van Der Weide, Deputy Director, Division of Banking Supervision and Regulation, Federal Reserve Board of Governors, statement before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, April 28, 2015. Van Der Weide stated: “The insurance holding companies for which the Federal Reserve is the consolidated supervisor hold approximately one-third of U.S. insurance industry assets and vary greatly in size and in the types of products they offer.” In his oral testimony, Van Der Weide indicated that the Federal Reserve supervises 17 insurers. U.S. Senate, Committee on Banking, Housing, and Urban Affairs, “Hearings: The State of the Insurance Industry and Insurance Regulation,” April 28, 2015, video, (at approximately 1:25), <http://www.banking.senate.gov/public/index.cfm/hearings?ID=29608126-AE85-4568-87B2-14E1A61D9774> (accessed February 24, 2016). See also Bipartisan Policy Center, “How the Federal Reserve Became the De Facto Federal Insurance Regulator,” July 30, 2014, <http://bipartisanpolicy.org/blog/how-federal-reserve-became-de-facto-federal-insurance-regulator> (accessed February 17, 2016).
25. Dodd–Frank § 604(g) and (h) (amending 12 U.S. Code § 1467a(b)).
26. Dodd–Frank § 604(h) (amending 12 U.S. Code § 1467a(b)(4)).

27. Dodd–Frank § 605(a) (amending 12 U.S. Code § 1811 et seq.).
28. State-regulated insurance companies are functionally regulated subsidiaries (and thus not subject to this provision), but only “with respect to insurance activities of the insurance company and activities incidental to such insurance activities.” 12 U.S. Code § 1844(c)(5)(iv)(2014).
29. Van Der Weide, statement before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate.
30. See, for instance, “Board of Governors of the Federal Reserve System, Notice of Intent to Apply Certain Supervisory Guidance to Savings and Loan Holding Companies,” *Federal Register*, Vol. 76, April 22, 2011, p. 2263. The notice explains that “the Board’s consolidated supervision program may entail more intensive supervisory activities than under current OTS practice, at least for some SLHCs.” The notice further explains that this approach “may entail more rigorous review of internal control functions and consolidated liquidity, as well as the conduct of discovery reviews of specific activities” and “may entail heightened review of the activities of nonbank subsidiaries.” *Ibid*.
31. Board of Governors of the Federal Reserve System, Division of Banking Supervision and Regulation, “Incorporation of Federal Reserve Policies into the Savings and Loan Holding Company Supervision Program,” *Supervision and Regulation Letter* SR 14-9, November 7, 2014.
32. *Ibid*. See attachment Listing of Federal Reserve Guidance Applicable to Savings and Loan Holding Companies Issued Prior to Transfer Date of July 21, 2011 (as of November 7, 2014).
33. See, for instance, Bibeka Shreshtha, “Think Tank Unveils Road Map for US Financial Oversight,” Law360.com, April 10, 2014, <http://www.law360.com/articles/527088/think-tank-unveils-road-map-for-us-financial-oversight> (accessed February 17, 2016). Shreshtha quotes Aaron Klein, director of the Bipartisan Policy Center’s Financial Regulatory Reform Initiative: “We’re four years into Dodd–Frank, the Federal Reserve is still trying to hire people with insurance expertise. That’s kind of stunning to me.” But, see also Van Der Weide, statement before the Senate Committee on Banking, Housing, and Urban Affairs, U.S. Senate: “The Federal Reserve is investing significant time and effort into enhancing our understanding of the insurance industry and firms we supervise, and we are committed to tailoring our supervisory framework to specific business lines, risk profiles, and systemic footprints of the insurance holding companies we oversee.”
34. For a discussion of the Federal Reserve’s international role and how it might conflict with state-based insurance regulation, see Paul H. Kupiec, “Federal Reserve Accountability and Reform,” statement for the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, March 4, 2015, <http://www.aei.org/publication/federal-reserve-accountability-reform-2/> (accessed February 17, 2016).
35. Van Der Weide, statement before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate.
36. Kupiec, “Federal Reserve Accountability and Reform.”
37. See, for instance, Robert C. Eager and Cantwell F. Muckenfuss III, “Creating Federal Insurance Regulation: A Zero-Based Approach,” in Peter J. Wallison, ed., *Optional Federal Chartering and Regulation of Insurance Companies* (Washington, DC: AEI Press, 2000), pp. 153 and 163. Muckenfuss contends that one of the benefits of an optional federal charter would be “the presence of an agency with in-depth industry knowledge within the federal government.”
38. 31 U.S. Code § 313(d). Long-term care insurance is within the FIO’s jurisdiction if it “is included with life or annuity insurance components.” 31 U.S. Code § 313(d)(2).
39. 31 U.S. Code § 313(c).
40. 31 U.S. Code § 313(b). The FIO director has a “career reserved position in the Senior Executive Service,” which means that he is a career appointee for whom “[d]isciplinary removal procedures and rights are similar to those for competitive service employees, except that the standard for action is ‘misconduct, neglect of duty, malfeasance, or failure to accept a directed reassignment or to accompany a position in a transfer of function.’” Office of Personnel Management, “Senior Executive Service,” <https://www.opm.gov/policy-data-oversight/senior-executive-service/performance/#url=Suspension+%26+Removal> (accessed September 2, 2015). Arguably, however, the Treasury Secretary could control the FIO director by threatening to deny the FIO staff and other resources. Dodd–Frank § 502 (adding 31 U.S. Code § 313(q)).
41. Dodd–Frank § 502 (adding 31 U.S. Code § 313(h)).
42. Dodd–Frank § 502 (adding 31 U.S. Code § 313(k)).
43. News release, “Remarks by Federal Insurance Office Director Michael McRaith at Property/Casualty Insurance Joint Industry Forum,” U.S. Department of the Treasury, January 10, 2012, <http://www.treasury.gov/press-center/press-releases/Pages/tg1393.aspx> (accessed February 17, 2016). McRaith stated: “To be clear, FIO is not a regulator—that remains the province of the states.” In the same speech, however, McRaith promised that the FIO would not “sit idly by while the world spins” and would be “engaged and assertive, when necessary, to offer views, leadership, and guidance on insurance in the United States.”
44. Patricia A. McCoy, “Systemic Risk Oversight and the Shifting Balance of State and Federal Authority Over Insurance,” Boston College Law School *Legal Studies Research Paper* No. 349, January 1, 2015, p. 36.
45. Dodd–Frank § 502 (adding 31 U.S. Code § 313(c)(2)).
46. One commentator points out: “Whereas states are limited to the McCarran–Ferguson Act’s definition of the ‘business of insurance,’ the Dodd–Frank Act expands the federal government’s reach to ‘all aspects of the insurance industry.’” Kelly Kirby, “Supervisory Colleges: Improving International Supervisory Coordination,” *Connecticut Insurance Law Journal*, Vol. 19 (2012), p. 184.
47. Dodd–Frank § 502 (adding 31 U.S. Code § 313(c)(1)).

48. An “insurer” is defined as “any entity that writes insurance or reinsures risks and issues contracts or policies in 1 or more States.” Dodd–Frank § 502 (adding 31 U.S. Code § 313(e)(2)(B)).
49. An “affiliate” is “any person who controls, is controlled by, or is under common control with the insurer.” Dodd–Frank § 502 (adding 31 U.S.C. § 313(r)(1)).
50. Dodd–Frank § 502 (adding 31 U.S. Code § 313(e)(1)).
51. Dodd–Frank § 502 (adding 31 U.S. Code § 313(e)(3)).
52. Dodd–Frank § 502 (adding 31 U.S. Code § 313(e)(4)).
53. Dodd–Frank § 502 (adding 31 U.S. Code § 313(e)(6)).
54. Dodd–Frank § 502 (adding 31 U.S. Code § 313(e)(5)).
55. Dodd–Frank § 502 (adding 31 U.S. Code § 313(e)(5)).
56. 31 U.S. Code § 313(c)(3), and Dodd–Frank § 111(b)(2)(B) (12 U.S. Code § 5321(b)(2)(B)).
57. Dodd–Frank § 165(i) (12 U.S. Code § 5365(i)).
58. Dodd–Frank § 203(a)(1)(C) (12 U.S. Code § 5383(a)(1)(C)).
59. Dodd–Frank §§ 203(a)(1)(C) and (b) (12 U.S. Code § 5383(a)(1)(C) and (b)).
60. Dodd–Frank § 502 (adding 31 U.S. Code § 313(c)(1)(E)).
61. *Ibid.* The Federal Reserve, the National Association of Insurance Commissioners (NAIC), and the states are also members. See International Association of Insurance Supervisors, “About the IAIS: IAIS Members,” <http://iaisweb.org/index.cfm?event=getPage&nodeId=25189> (accessed February 17, 2016). Aaron Klein points out that the multiple representation may “sen[d] an unclear signal to the international community as to who speaks for the United States between the chair of the Federal Reserve Board, the director of FIO, or the NAIC.” Hearing, *Finding the Right Capital Regulations for Insurers*, Subcommittee on Financial Institutions and Consumer Protection, Committee on Banking, Housing & Urban Affairs, U.S. Senate, 113th Cong., 2nd Sess., March 11, 2014, statement by Aaron Klein, Director, Financial Regulatory Reform Initiative, Bipartisan Policy Center.
62. Federal Insurance Office, “How to Modernize and Improve the System of Insurance Regulation in the United States,” December 2013, p. 64.
63. For a discussion of international insurance regulatory issues and structures, see Therese M. Vaughan and Mark A. Calabria, “International Developments in the Insurance Sector: The Road to Financial Instability?” Cato Institute *Working Paper* No. 30, May 27, 2015.
64. Dodd–Frank sets forth the procedures pursuant to which the Treasury Secretary and U.S. Trade Representative negotiate covered agreements and Congress has an opportunity to weigh in. Dodd–Frank § 502 (adding 31 U.S. Code § 314). One of the FIO’s functions is “assisting the Secretary in negotiating covered agreements.” Dodd–Frank § 502 (adding 31 U.S. Code § 313(c)(1)(E)). The FIO, however, claims a more direct role. “Under Title V of the Dodd–Frank Act, FIO and the United States Trade Representative (USTR) are authorized, jointly, to negotiate and enter into ‘covered agreements.’” FIO, “How to Modernize and Improve the System of Insurance Regulation in the United States,” p. 38.
65. Dodd–Frank § 502 (adding 31 U.S. Code § 313(f)(1)). The state measures that may be pre-empted include “any State law, regulation, administrative ruling, bulletin, guideline, or practice relating to or affecting prudential measures applicable to insurance or reinsurance.” Dodd–Frank § 502 (adding 31 U.S. Code § 313(r)(7)).
66. Dodd–Frank § 502 (adding 31 U.S. Code § 313(r)(2)).
67. Dodd–Frank § 502 (adding 31 U.S. Code § 313(j)).
68. See, for instance, Scott Harrington, “Federal Chartering of Insurance Companies: Options and Alternatives for Transforming Insurance Regulation,” Networks Financial Institute *Policy Brief* No. 2006-PB-02, February 2006, p. 3, [http://www.scottharringtonphd.com/2006-pb-02\\_Harrington.pdf](http://www.scottharringtonphd.com/2006-pb-02_Harrington.pdf) (accessed February 17, 2016). Harrington explains: “Despite a number of positive and incremental reforms throughout the past decade, several key aspects of state insurance regulation, including regulation of rates, rate classification, and policy forms, remain substantially dysfunctional in many states—with no end in sight and with significant burdens on interstate commerce. A transformation of insurance regulation to reduce those burdens by promoting healthy price and product competition and eliminating regulatory micromanagement of price and product decisions will not be achieved without federal intervention.”
69. See, for instance, Letter from Anne Wall, Assistant Secretary for Legislative Affairs, Department of the Treasury and Mike Henry, Assistant U.S. Trade Representative for Congressional Affairs, Office of the U.S. Trade Representative, to Richard Shelby, Chairman, Senate Committee on Banking, Housing, and Urban Affairs, November 20, 2015, <https://www.treasury.gov/initiatives/fio/reports-and-notices/Documents/Covered%20Agreement%20Letters%20to%20Congress.pdf> (accessed February 17, 2016).
70. *Ibid.*, p. 2.
71. *Ibid.*

72. Bipartisan Policy Center, "Global Insurance Regulatory Issues: Implications for U.S. Policy and Regulation," November 2015, <http://bipartisanpolicy.org/library/global-insurance-regulatory-issues/> (accessed February 17, 2016). This piece describes the disagreements between the National Association of Insurance Commissioners and the FIO on this issue and concludes that "[t]his makes reinsurance collateral a potential target for a covered agreement and federal preemption of state measures that address the subject." See also National Association of Insurance Commissioners, "Covered Agreement," August 24, 2015, [http://www.naic.org/cipr\\_topics/topic\\_covered\\_agreement.htm](http://www.naic.org/cipr_topics/topic_covered_agreement.htm) (accessed February 17, 2016). The NAIC writes: "In light of the progress made by the NAIC and the states to modernize credit for reinsurance rules, the NAIC is neither convinced nor persuaded that a covered agreement for reinsurance collateral is necessary."
73. Dodd-Frank § 502 (adding 31 U.S. Code § 313(f)(2)(A)).
74. Dodd-Frank § 502 (adding 31 U.S. Code § 313(f)(2)(C) and (3)).
75. Dodd-Frank § 502 (adding 31 U.S. Code § 313(f)(2)(B)).
76. Dodd-Frank § 502 (adding 31 U.S. Code § 313(g)).
77. Schwarcz and Schwarcz, "Regulating Systemic Risk in Insurance," pp. 1635-1636. The authors call for the FIO to have authority, subject to the FSOC's sign-off, to pre-empt state law for systemic-risk reasons.
78. Dodd-Frank § 502 (adding 31 U.S. Code § 313(p)).
79. Dodd-Frank § 502 (adding 31 U.S. Code § 313(p)(3)).
80. FIO, "How to Modernize and Improve the System of Insurance Regulation in the United States," p. 5. The report concludes that "the proper formulation of the debate at present is not whether insurance regulation should be state or federal, but whether there are areas in which federal involvement in regulation under the state-based system is warranted." See also Elizabeth D. Festa, "FIO Modernization Report: It's Out, But Where Is It Going?" LifeHealthPro, December 13, 2013, <http://www.lifehealthpro.com/2013/12/13/fio-modernization-report-its-out-but-where-is-it-going?life-products> (accessed February 17, 2016). Festa notes that the FIO's "long-simmering report on modernization was greeted like a wonk's Rorschach ink blot" because it "either affirms state regulation or allows for the hand of the federal government to guide insurance regulation down a smoother path, both for interested parties and for itself in certain areas."
81. FIO, "How to Modernize and Improve the System of Insurance Regulation in the United States," p. 5.
82. *Ibid.*
83. *Ibid.*
84. *Ibid.*, pp. 31-32.
85. *Ibid.*, pp. 41-42.
86. FIO, *Annual Report on the Insurance Industry*, September 2015, App. p. vi, [https://www.treasury.gov/initiatives/fio/reports-and-notice/Documents/2015%20FIO%20Annual%20Report\\_Final.pdf](https://www.treasury.gov/initiatives/fio/reports-and-notice/Documents/2015%20FIO%20Annual%20Report_Final.pdf) (accessed February 17, 2016).
87. Michael Nelson and Nicholas Bacon, "The Long Arm of the FIO," *Insider Quarterly* (Spring 2014), <http://www.insiderquarterly.com/the-long-arm-of-the-fio> (accessed February 17, 2016). Nelson and Bacon write: "If the FIO joins the supervisory colleges, it may provide a platform for the FIO to become involved in regulatory decisions despite being denied regulatory authority under Dodd-Frank."
88. FIO, "How to Modernize and Improve the System of Insurance Regulation in the United States," p. 42. The report concludes: "Given concerns about the adequacy of solo entity supervision for larger groups, particularly for U.S.-based firms operating globally, consolidated supervision for large, internationally-active U.S.-based insurance firms will require continued focus and *national* attention." (Emphasis added).
89. FIO, *Annual Report on the Insurance Industry*, pp. 58-59. The annual report notes the move away from risk-based capital to principles-based reserving (PBR), which "relies heavily on each insurer's application of internal models to complex data sets, which are unique to each insurer, and necessarily demanding of expertise and resources," and observes that "[t]his approach makes sense from the industry perspective, but raises questions about the limitation of state regulatory capacity." And, on App. p. x, the report notes that the NAIC's "Commercial Lines Working Group recommends against the development of an interstate compact for commercial lines, thereby potentially preserving an unnecessary inefficiency that neither bolsters consumer protection nor promotes efficiency of insurance regulatory oversight."
90. Martin F. Grace and Robert W. Klein, "Efficiency Implications of Alternative Regulatory Structures for Insurance," in Wallison, ed., *Optional Federal Chartering and Regulation of Insurance Companies*, p. 84. Grace and Klein observe that a federal regulator might be more susceptible than a state regulator to "interest-group pressures" pushing for "regulations motivated by social and political preferences" in lieu of competitive outcomes. See also Scott E. Harrington, "The History of Federal Involvement in Insurance Regulation," in Wallison, ed., *Optional Federal Chartering and Regulation of Insurance Companies*, p. 39. Harrington notes that the existence of state competition may be salutary in ensuring that regulation does not become a way "to promote inefficient wealth transfers."
91. FIO, "How to Modernize and Improve the System of Insurance Regulation in the United States," pp. 6-7. The report recommends a list of action items for states, including converging "[s]tate-based solvency oversight and capital adequacy regimes...toward best practices and uniform standards," "adopt[ing] and enforce[ing] the National Association of Insurance Commissioners Suitability in Annuities Transactions Model Regulation," and "extend[ing] regulatory oversight to vendors that provide insurance score products to insurers."
92. FIO, *Annual Report on the Insurance Industry*, p. 54.
93. *Ibid.*, pp. 45-46.

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94. Ibid., p. 48.
  95. Ibid., pp. 47–48.
  96. Ibid., p. 66.
  97. FIO, “How to Modernize and Improve the System of Insurance Regulation in the United States,” p. 8. The report recommends that “should the states fail to accomplish necessary modernization reforms in the near term, Congress should strongly consider direct federal involvement.” The report goes on to consider ways in which the federal government could get involved, including direct federal regulation. Ibid., pp. 8–10.
  98. FIO, “How to Modernize and Improve the System of Insurance Regulation in the United States,” pp. 54–56, and FIO, *Annual Report on the Insurance Industry*, App. p. xii. In light of NAIC inaction, the FIO announces its intention to “move forward to identify those states and markets where a reduction in rate oversight could be tested.”
  99. James Buchanan, “Politics Without Romance: A Sketch of Public Choice Theory and Its Normative Implications,” *The Logical Foundations of Constitutional Liberty*, Vol. 1 (1999), pp. 45 and 57. Buchanan notes the ability of bureaucracies to “manipulate the agenda for legislative action for the purpose of securing outcomes favorable to its own interests” and to “play off one set of constituents against others, insuring that budgets rise much beyond plausible efficiency limits.”
  100. FIO, “How to Modernize and Improve the System of Insurance Regulation in the United States,” p. 58.
  101. Dodd–Frank §§ 521–525 (15 U.S. Code §§ 8201–8205).
  102. FIO, “How to Modernize and Improve the System of Insurance Regulation in the United States,” p. 59.
  103. Dodd–Frank §§ 531–532 (15 U.S. Code §§ 8221–8222).
  104. Ibid.
  105. This list is drawn from a more comprehensive list in Harrington, “Federal Chartering: Options and Alternatives for Transforming Insurance Regulation.” For a helpful history of the development of state insurance regulation, see Harrington, “The History of Federal Involvement in Insurance Regulation.” Harrington observes that the “history of insurance regulation is characterized by a series of perceived market or regulatory failures, followed by threats of federal regulation and subsequent changes by the states that have helped forestall federal action.” Harrington, “History of Federal Involvement,” p. 21.
  106. For a discussion of risk-based capital, see NAIC, “Risk-Based Capital,” [http://www.naic.org/cipr\\_topics/topic\\_risk\\_based\\_capital.htm](http://www.naic.org/cipr_topics/topic_risk_based_capital.htm) (accessed September 10, 2015).
  107. For a discussion of state guaranty funds, see Peter G. Gallanis, “Policyholder Protection in the Wake of the Financial Crisis,” in Biggs and Richardson, eds., *Modernizing Insurance Regulation*, pp. 207–240.
  108. Peter J. Wallison, “Competitive Equity: An Optional Federal Charter for Insurance Companies,” AEI Financial Services Outlook, March 2006, pp. 1–2. Wallison points out the competitive disadvantage that insurers face in comparison to banks and securities firms.
  109. See generally, Harrington, “Federal Chartering: Options and Alternatives for Transforming Insurance Regulation.”
  110. Sheila Bair, “Consumer Ramifications of an Optional Federal Charter for Life Insurers,” University of Massachusetts Isenberg School of Management, 2004, p. 2, [http://www.socmavotes.com/afc/UMass\\_Report.pdf](http://www.socmavotes.com/afc/UMass_Report.pdf) (accessed February 17, 2016). Bair’s report explains: “Difficulties and time delays in securing form filing approvals inhibits the ability of life insurers to modify products in response to consumer demand and impairs competition with banks and securities firms which do not have to undergo advance merit review of permitted product offerings.”
  111. See, for instance, Elizabeth Brown, “Implementing the Dodd–Frank Wall Street Reform and Consumer Protection Act: Will the FIO Improve Insurance Regulation?” *University of Cincinnati Law Review*, Vol. 81 (2012), p. 566. Brown explains: “The significant costs involved, both in terms of time and money, for a company to get licensed as an insurance provider and to get its products licensed have created substantial barriers to entry in the insurance industry.”
  112. For a discussion of the international concerns raised by the existing state-based system, see Brown, “Implementing the Dodd–Frank Wall Street Reform and Consumer Protection Act,” p. 566.
  113. Martin Grace and Richard Phillips, “The Allocation of Governmental Regulatory Authority: Federalism and the Case of Insurance Regulation,” *Journal of Risk and Insurance*, Vol. 74 (2007), p. 208. Grace and Phillips explain that insurer insolvencies in the late 1980s and early 1990s raised congressional concern about state insurance regulation. State and federal regulators missed the problems at AIG. See, for instance, Roddy Boyd, *Fatal Risk: A Cautionary Tale of AIG’s Corporate Suicide* (New York: Wiley, 2011), and David J. Merkel, “To What Degree Were AIG’s Operating Insurance Subsidiaries Sound?” *Finacorp Securities*, April 28, 2009, <http://alephblog.com/wp-content/uploads/2009/04/To%20What%20Degree%20Were%20AIG%E2%80%99s%20Operating%20Subsidiaries%20Sound.pdf> (accessed February 17, 2016).
  114. NAIC, “About the NAIC,” [http://www.naic.org/index\\_about.htm](http://www.naic.org/index_about.htm) (accessed September 10, 2015). The NAIC explains: “Through the NAIC, state insurance regulators establish standards and best practices, conduct peer review, and coordinate their regulatory oversight.” See also Grace and Klein, “Efficiency Implications of Alternative Regulatory Structures for Insurance,” pp. 94–95. Grace and Klein list services provided by the NAIC.
  115. Michael Kerley, “Insurance Agents and Advisors,” in *Optional Federal Chartering and Regulation of Insurance Companies*, p. 176. Kerley observes: “Every time there is movement in the federal government to step in and do something, it seems to spur the NAIC, and state insurance commissioners in general, to go forward.”
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116. As Roger Ferguson explains, “legislators in some large and important states, perhaps wary of additional oversight and loss of authority within their borders, have refused to join [multi-state compacts created by the NAIC], limiting their effectiveness.” Roger W. Ferguson Jr., “Why Insurance Needs a Federal Regulator Option,” in Biggs and Richardson, eds., *Modernizing Insurance Regulation*, p. 27.
117. For arguments on both sides and the complexities associated with transitioning to federal insurance regulation, see Biggs and Richardson, eds., *Modernizing Insurance Regulation*, and Wallison, ed., *Optional Federal Chartering and Regulation of Insurance Companies*.
118. For a discussion of the historical arguments for federal involvement in insurance regulation and the states’ responses, see Brown, “Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act,” pp. 560–579, and McCoy, “Systemic Risk Oversight and the Shifting Balance of State and Federal Authority Over Insurance,” pp. 11–16.
119. Eric Dinallo, “Lessons Learned from AIG for Modernizing Insurance Regulation,” Biggs and Richardson, eds., *Modernizing Insurance Regulation*, pp. 243–260.
120. Jack R. Wahlquist, “Why the Dogs Are Not Barking,” in Wallison, ed., *Optional Federal Chartering and Regulation of Insurance Companies*, p. 68.
121. See, for instance, Bair, “Consumer Ramifications of an Optional Federal Charter for Life Insurers,” pp. 2–3. Bair summarizes prior policy discussions of the optional federal insurance charter. See also Bill McCartney and Bob Litan, “Revisiting Insurance Regulatory Reform in a Post-Crisis World,” *The Hill*, March 10, 2015. McCartney and Litan call for consideration of “whether an optional federal insurance charter makes sense in a post-Dodd Frank world.” For different views about the need for and implications of an optional federal charter, see Wallison, ed., *Optional Federal Chartering and Regulation of Insurance Companies*. Recommendations for federal charters also have taken shape in the form of legislative proposals. See, for instance, H.R. 1880, 111th Cong., 1st Sess. (2009), which proposed to create an Office of National Insurance to oversee national insurers; S. 40, 110th Cong., 1st Sess., 2007, which proposed to create an Office of National Insurance to oversee national insurers; and H.R. 4900, 102nd Cong., 2nd Sess., 1992, which proposed to create a Federal Insurance Solvency Commission with the power to “issue a certificate of solvency to engage in the business of insurance.”
122. See, for instance, Eager and Muckenfuss III, “Creating Federal Insurance Regulation: A Zero-Based Approach,” pp. 153–154. Eager observed: “To replicate the existing state system at the federal level makes no sense. We can and should develop a federal charter that embodies contemporary insights about regulation, market dynamics, and best practices in general.”
123. See, for instance, Joel Wood, “Broker Organizations,” in Wallison, ed., *Optional Federal Chartering and Regulation of Insurance Companies*, p. 173. Wood argues: “Especially in the commercial context, the insurance business is...national and international in scope and character as are the businesses of those who seek insurance protection.”
124. See, for instance, Ferguson Jr., “Why Insurance Needs a Federal Regulator Option,” p. 26. Ferguson contends: “The convergence of [financial services] industries, without any accompanying change in the insurance regulatory system, has left insurers—at least those with a national footprint—at a competitive disadvantage.” See also Wallison, ed., *Optional Federal Chartering for Life Insurance Companies*, pp. 51–52. Wallison points out the competitive disadvantage faced by life insurance companies as compared to banks and securities firms, which “appear to have competitive advantages arising out of their more flexible regulatory regimes.”
125. For a concise discussion of the benefits of an optional federal charter, see Wallison, “Competitive Equity: An Optional Federal Charter for Insurance Companies.” See also Hal Scott, “Optional Federal Chartering of Insurance: Design of a Regulatory Scheme,” Networks Financial Institute *Policy Brief* No. 2007-PB-04, March 2007.
126. See, for instance, Bert Ely, “The Fate of the State Guaranty Funds After the Advent of Federal Insurance Chartering,” in Wallison, ed., *Optional Federal Chartering and Regulation of Insurance Companies*, p. 137. Ely compares insurance to a product warranty and explains that “if government wants to be in the business, for whatever reason, of regulating financial institutions, then it has no choice but to provide a warranty for the service that business supposedly provides to the general public.” See also Harrington, “The Financial Crisis, Systemic Risk, and the Future of Insurance Regulation,” p. 810. Harrington predicts: “The history of federal deposit insurance and TBTF policy suggests that, either initially or later on, [an optional federal charter] could expand government guarantees of insurers’ obligations, thereby undermining market discipline and incentives for safety and soundness.” Some are already calling for a federal safety net as an alternative to the existing state guaranty system. See, for instance, John H. Biggs, “Modernizing the Safety Net for Insurance Companies,” in Biggs and Richardson, eds., *Modernizing Insurance Regulation*, pp. 181–205. Biggs identifies flaws—including lack of uniformity, lack of prefunding, inadequacy to deal with large failures, and absence of risk-based pricing—in the state guaranty association structure and calls for a federal system based on the FDIC.
127. Others have suggested an independent bureau within Treasury modeled on the Office of the Comptroller of the Currency. See, for instance, Eager and Muckenfuss III, “Creating Federal Insurance Regulation: A Zero-Based Approach,” p. 159. Given that the federal regulator would have policymaking responsibilities, however, a politically balanced commission is a better model.
128. The Federal Reserve would not be a good candidate for serving as the federal insurance regulator. See, for instance, *ibid.* Eager points out that “[b]ank regulation today is a secondary function at the Fed, and it is not clear how the addition of an insurance regulatory mission would fit into that agency’s structure,” and notes that the “secondary importance of the regulatory function today tends to magnify the clout of Fed staff, which has even less public accountability than have the Fed governors.”
129. In the area of consumer protection, some states have shown a lack of appreciation for the importance of access and competition to consumers, but it is not clear that a federal regulator would be any better. In the area of consumer finance regulation, for example, the newly created Bureau of Consumer Financial Protection has been criticized for failing to properly assess the value of consumer choice and access. See, for instance, Todd Zywicki, “The Dodd-Frank Act Five Years Later: Are We More Stable?” statement before the Committee on Financial Services, U.S. House of Representatives, 114th Cong., 2015.

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130. Scott Harrington has warned that federal regulation carries with it a greater likelihood of bailouts. See, for instance, Harrington, “Insurance Regulation and the Dodd-Frank Act,” Networks Financial Institute *Policy Brief* No. 2009-PB-01, March 2011, p. 13.
  131. Grace and Klein, “Efficiency Implications of Alternative Regulatory Structures for Insurance,” p. 125. According to Grace and Klein’s careful, empirical analysis, an optional federal charter likely would generate small savings in solvency and financial regulation, larger savings in market regulation, but nevertheless small savings in the aggregate when compared with total industry premiums. But, see also, Bair, “Consumer Ramifications of an Optional Federal Charter for Life Insurers,” Executive Summary. Bair concludes “that the current multi-state system is structurally resistant to needed reforms, even in the face of broad consensus that greater uniformity and centralization is needed in the oversight of life insurance products.”
  132. Henry N. Butler and Larry E. Ribstein, “A Single-License Approach to Regulating Insurance,” *Northwestern Law and Economics Research Paper* No. 08-10, 2008.
  133. *Ibid.*, p. 15.
  134. Harrington, “Federal Chartering of Insurance Companies: Options and Alternatives for Transforming Insurance Regulation,” p. 28.
  135. Roberta Romano, *The Genius of American Corporate Law* (Washington, DC: AEI Press, 1993).
  136. Vaughan and Calabria, “International Developments in the Insurance Sector: The Road to Financial Instability?” p. 10. See also HM Revenue & Customs, *General Insurance Manual*, § 3030: “Regulatory Framework: the European ‘Single Passport,’” <http://www.hmrc.gov.uk/manuals/gimmanual/gim3030.htm> (accessed February 17, 2016). The manual explains that under “the ‘single passport’ framework, “[c]ompanies whose head office is elsewhere in the European Economic Area (currently the EU countries together with Norway, Iceland and Liechtenstein) are permitted to conduct insurance business in the UK on the strength of an authorisation in their Home State.”
  137. Therese M. Vaughan, “Observations on Insurance Regulation—Uniformity, Efficiency, and Financial Stability,” in Biggs and Richardson, eds., *Modernizing Insurance Regulation*, pp. 31 and 39.
  138. See, for instance, Grace and Phillips, “The Allocation of Governmental Regulatory Authority: Federalism and the Case of Insurance Regulation,” p. 211. Grace and Phillips find that in 2000, “the average state used only 8.78 percent of the revenues collected from the insurance industry to finance the operations of the regulator in the state.”
  139. Such concerns were the impetus for Europe’s Solvency II initiative. See Vaughan and Calabria, “International Developments in the Insurance Sector: The Road to Financial Instability?” and European Commission, “Internal Market and Services DG,” pp. 10–12. See also “Solvency II: Frequently Asked Questions (FAQs),” [http://ec.europa.eu/internal\\_market/insurance/docs/solvency/solvency2/faq\\_en.pdf](http://ec.europa.eu/internal_market/insurance/docs/solvency/solvency2/faq_en.pdf) (accessed February 7, 2016). The FAQs explain: “The third-generation Insurance Directives established an ‘EU passport’ (single licence) for insurers based on the concept of minimum harmonisation and mutual recognition. Many Member States have concluded that the current EU minimum requirements are not sufficient and have implemented their own reforms, thus leading to a situation where there is a patchwork of regulatory requirements across the EU. This hampers the functioning of the Single Market.”
  140. As Scott Harrington has pointed out, state guaranty funds’ purported inadequacy may actually be useful in prompting effective market discipline. Harrington, “Insurance Regulation and the Dodd-Frank Act,” p. 13.
  141. Currently, a state’s guaranty fund is responsible only for the policyholders residing in their state. Gallanis, “Policyholder Protection in the Wake of the Financial Crisis,” p. 220. Gallanis explains: “A covered person is protected by the guaranty association of the jurisdiction where the person resides at the time the insurer fails, even though the insurer whose liquidation triggers the association’s coverage responsibility may be domiciled in a different jurisdiction.”
  142. As Bert Ely has explained, “Premium tax offsets permit surviving insurance companies to pass the cost of insurance company failures through to general taxpayers.” Ely, “The Fate of the State Guaranty Funds After the Advent of Federal Insurance Chartering,” p. 142.
  143. Butler and Ribstein, “A Single-License Approach to Regulating Insurance,” p. 18.
  144. *Ibid.*
  145. Cummins and Weiss, “Systemic Risk Regulation of the U.S. Insurance Industry,” pp. 110 and 125. Cummins and Weiss argue that “the key to effective insurance regulation is to design a regulatory system that effectively encompasses both core and noncore enterprises of the insurance sector and coordinates regulation across national boundaries,” but they also note that “it is not clear that federal regulators would be more effective than state regulators.” States recently have been focusing more attention on group supervision. See National Association of Insurance Commissioners, “Group Supervision,” December 14, 2015, [http://www.naic.org/cipr\\_topics/topic\\_group\\_supervision.htm](http://www.naic.org/cipr_topics/topic_group_supervision.htm) (accessed February 18, 2016).
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