



February 14, 2008

Marc Racicot, President
American Insurance Association
1130 Connecticut Avenue, NW
Suite 1000
Washington, D.C. 20036

Dear Mr. Racicot:

I read with interest your letter and news release calling for state insurance regulators to reconsider their opposition to an optional federal charter (OFC). Some of your comments raise questions that should be discussed and clarified.

As President of the American Insurance Association (AIA), one of the largest property/casualty trade groups, you know firsthand how important insurance-related issues are to our nation’s consumers. Property/casualty insurance is a local product, with local issues that require a responsive, local regulator to help resolve consumers’ complaints and address their concerns.

There are presently more than 11,000 individuals working in state insurance departments across this country who help to protect insurance consumers. It takes quite an imagination to assume the Treasury Department could assume even a partial role in regulating insurance without creating a huge bureaucracy. The plain and simple truth is optional federal chartering would create a new federal bureaucracy from scratch and allow insurance companies to “opt out” of comprehensive consumer protections and state oversight. Current proposals would gut consumer protection, while outsourcing most critical regulatory functions to an industry-run self-regulatory organization.

In addition, allowing insurers to pick their regulator threatens a regulatory “race-to-the-bottom.” This scheme would be especially dangerous in property/casualty insurance, where families and businesses faced with a storm, fire, illness or injury often rely on a hands-on regulator to make insurers keep their promises and to help rebuild quickly after an unforeseen disaster. The push for an OFC is, in reality, nothing more than a call for little or no regulation.

And, as a former governor, I’m sure you understand how important premium tax dollars are to the livelihood of every state in our union. In 2006, the states collected more than \$16.7 billion in revenues from insurance sources. Of this amount, \$1.2 billion — roughly 7.2 percent — went to regulate the business of insurance, while the remaining \$15.5 billion went to the states’ general funds for other purposes. This begs the question: How would any new federal bureaucracy be funded, if not by state premium tax dollars? Surely you are not proposing that the AIA’s member companies would be willing to pay an assessment to the federal government, in addition to the premium tax they would continue to pay to their domiciliary state. That would undoubtedly result in higher premiums for American consumers.

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I would also like to clarify and correct some of your observations:

- While the current draft of the National Insurance Act preserves premium tax revenues for the states, we do not have to look very far back in history to find a national solution that funded premium taxes for a while and then reversed course. I refer you to the Federal Crop Insurance Program. Historically, the FCIC reimbursed crop insurers for the premium taxes that they were required to pay to the states. Then, in the early 1990s, in a case involving my home state of Kansas, the FCIC sued then-Commissioner Ron Todd for charging insurers a tax that they maintained was preempted by federal law. This led to a multi-state agreement where the FCIC agreed not to pursue the reimbursement of past premium tax revenues in exchange for an agreement that all states would not collect them in the future. This also led to a clarifying law enacted by Congress to make it completely clear that the states were preempted from collecting premium taxes for federal reinsurance crop insurance products. We believe that the ink would barely be dry on the National Insurance Act before national insurers would be calling for an amendment to the provision allowing the states to collect premium taxes.
- Consumers do not generally choose their bank or their insurer based upon its regulatory framework. I am certain that most national bank customers do not know the primary regulators of the bank are the Office of the Comptroller of the Currency and the Federal Reserve. In reality, consumers select a bank based on the products and services that the financial institution offers. Bank regulators have a regulatory framework based on two main principles. The first is safety and soundness, which is the equivalent of solvency regulation for insurers. The second principle is disclosure. Bank regulators devote 90% of their resources to safety and soundness, leaving only 10% for their very weak version of consumer protection. In state-based insurance regulation, the resource split is closer to 50-50. Because insurance products are generally more complicated than bank products, this resource allocation is warranted. State insurance regulators believe that it would not be a consumer-driven choice of regulatory venue, but a situation where regulatory arbitrage would occur. The insurers — not the consumers — would make the selection of regulatory environments based on what is good for the insurer, rather than what is good for consumers.
- The National Insurance Act does, indeed, create a new federal bureaucracy. While it is housed within the Treasury, it is an oversimplification to say that no new bureaucracy would be created. The Treasury does not currently have staff devoted to insurance regulation; it does not have the infrastructure needed to collect the financial and market regulatory information that is needed to monitor insurer financial position and market conduct activities; and it does not have the necessary in-house expertise readily available without making substantial expenditures to secure that talent. To create and fund the necessary positions and infrastructure would be a major and unnecessary expense, in spite of the fact that the national insurers would be assessed to cover the costs.
- Consumers and insurers deserve a regulatory system that focuses on what is most important. They have that in the current state-based framework. It appears that the AIA's motivation for supporting a federal regulator is to allow complete pricing freedom — and I believe that you are more likely to achieve that means to an end through a federal regulator. While you might receive pricing freedom initially, you will only need to have a medical malpractice crisis or rapidly escalating auto insurance rates before that option disappears. Please remember that the bank regulatory framework is two-pronged, one of which is disclosure. I would expect that one of the first requirements to appear might be disclosure requirements related to insurer underwriting standards for various products. That is how the banks operate. If you want to test that theory, visit your friendly national bank and ask to see their underwriting standards for mortgage loans. A puzzled employee will go into the back room and will reappear with a copy of the detailed underwriting standards that the bank uses to evaluate underwriting risk. The standards will include the specific credit scores that lead one to receive one interest rate instead of another. Think of how wonderful it would be when insurers have to disclose that type of information to each auto or home insurance consumer.

I agree with you that the stakes are high. I would ask you to consider the failures of federal regulation, which caused the current problems in the financial markets, as another warning for restructuring the current insurance regulatory framework. Lax federal oversight caused the current disruption in the bond market. The Office of the Comptroller of the Currency allowed banks to offer unaffordable subprime loans to homeowners over the objection of state regulators, who sought to protect consumers from these unsafe products. The Federal Reserve allowed banks to hold risky derivative investments based on these subprime loans, which resulted in billions of dollars in write-downs. The Securities and Exchange Commission not only authorized these derivatives, it failed to supervise how credit agencies rated them. Everyone on the federal level who contributed the kindling, logs and matches that caused this fire should not now take away authority from state regulators who have been keeping the flames in check.

For more than 135 years, state-based insurance regulation has proven time and again that it can meet the challenges of our vibrant, dynamic industry. From bond insurance to long-term care insurance, state insurance regulators have remained steadfast in our commitment to protect insurance consumers — by ensuring the solvency and proper conduct of the companies we regulate and by providing information that helps every American be a smarter insurance consumer.

Regards,

A handwritten signature in cursive script that reads "Sandy Praeger". The signature is fluid and elegant, with a long, sweeping tail on the final letter.

Sandy Praeger
Kansas Insurance Commissioner
NAIC President