**RECORD OF SOCIETY OF ACTUARIES
1977 VOL. 3 NO. 4**

FEDERAL VS. STATE REGULATION

Moderator: ROBERT L. PAWELKO. Panelists: VINCENT W. DONNELLY, IAN L. ROLLAND, WILLIAM A. WHITE

1. Current activity in elimination of McCarran Act

2. Should the industry promote Federal regulation?

3. What is state regulation costing?

4. How would actuarial work differ under a Federal structure?

MR. VINCENT W. DONNELLY: When was the last time you picked up a newspaper, magazine or trade publication and did not find an article, editorial or letter-to-the-editor dealing with some phase of the regulation of business?

The growing amount of regulation and its impact upon my life was made very clear to me recently. Having been traveling quite a bit in recent weeks, I had lost touch with recent activities of our County Council until my wife handed me a copy of the Washington Post and pointed out a few articles of interest. The article indicated that life has changed rather substantially in Fairfax County, Virginia in recent days. I am no longer permitted to water my lawn -- Fairfax County is in the midst of a severe drought. I can no longer purchase non-returnable bottles. I am forbidden to smoke in public places and pornographic literature can no longer by publicly displayed.

I am not saying that Fairfax County is different from other counties -- in fact, it is probably a little behind. I am also not saying that these regulations are bad. What I am trying to emphasize is that our lives, both business and personal, are becoming increasingly regulated and there appears to be no end in sight.

As a member of the staff of the American Council of Life Insurance, I recently participated in the preparation of a paper for our Board of Directors which analyzed in detail the very same topic we are discussing here today -- state and Federal regulation of the insurance business. Just a recital of the chapter headings will give you some indication of the complexity of the problem -- Overregulation, Limited Regulation, Self-Regulation, Deregulation, and yes, Dual Regulation.

Your program says that Mr. Pawelko, Mr. Rolland, Mr. White and I are here to lead you in a discussion of who should regulate the insurance business. I would have wished that instead of placing the emphasis on who does the regulating, the program might have stressed the need for discussion of how we ought to be regulated. The only people who really care who does the regulating are those persons employed by the competing regulatory agencies. If you are employed within the insurance industry -- which the majority of you are -- then your primary concern has to be with how your business is regulated. Unfortunately, since it is more popular nowadays to participate in a popularity contest rather than develop an overall philosophy of regulation, I guess we are stuck with deciding "Who is going to do to us" rather than "What is going to be done to us."

Since you are all here today in lieu of attending the sessions on surplus needs, value of a life company, cost disclosure, individual disability income problems, group product development, and pension valuation, I have made two possibly invalid assumptions in preparing the rest of my remarks -- first, that you are sincerely concerned with insurance regulation and second, that you have a fairly good knowledge of the evolution of insurance regulation. This latter assumption is important because it allows me to spend minimal time on history and maximum time on the present and future.

With regard to history, suffice it to say that the comprehensive regulation of today originated with the famous Armstrong Committee away back in 1905. Since that time insurance supervision has traditionally been a function of state government. In 1944, however, the Supreme Court concluded that transactions of insurance constituted interstate commerce when conducted across boundaries and were, therefore, subject to the regulatory powers of the Federal government under the commerce power. Congress quickly responded in the following year to demonstrate its support of continuing the powers of the states to regulate the business of insurance by passing the McCarran-Ferguson Act. Briefly, this Act declares that the continued regulation of the business of insurance by the states is in the public interest and that no Act of Congress shall be construed to invalidate, impair or supercede any state law for this purpose unless the Act specifically relates to the business of insurance.

Okay, enough for history. It serves merely to point out that we are not dealing with a new phenomenon. But recent developments seem to indicate that the discussion may be reaching a new intensity and that we may indeed see a significant modification in the nature of insurance regulation in the not too distant future.

In the few minutes remaining to me this morning, I want to mention the event which I believe triggered this latest controversy and then briefly analyze the two most important arenas in which the foes are battling -- dual regulation and ERISA preemption. By selecting these two areas for discussion, I do not mean to downgrade the importance of other areas of current state-Federal conflict -- such as the Federal Trade Commission's investigation of our cost disclosure techniques. It is just that in the two areas identified any eventual outcome will affect either the entire industry or a very significant part of it -- rather than just one product.

Just for a moment, let us return to the ignition of the latest controversy. Very early this year the Department of Justice poked its nose under the tent of state regulation when it released a report which evaluated the various exemptions to the federal antitrust laws which have come into being over the past several decades (recall that the McCarran Act gave the insurance industry its antitrust immunity in 1945). It was the Department's conclusion that the antitrust exemption enjoyed by the insurance industry can no longer be fully justified and that a major reduction or elimination is now called for.

Of importance to our discussion today was the further reasoning by the Justice Department that since the antitrust exemption could not be proven to have "benefitted" the public then the state regulation which encourages it must by inference be deemed inferior to Federal regulation.

Out of this reasoning grew an interest in the concept of "dual regulation" and this interest culminated in the introduction in June of this year of

Senator Brooke's Federal Insurance Act of 1977. The proponents of this legislation argue that it combines the best features of state and Federal regulation -- freedom of choice as to type of regulation and strengthened financial guarantees through the establishment of a Federal guaranty fund. Equally vocal are the opponents who argue that the legislation combines the worst features of state and Federal regulations -- continuation of all existing state regulation of policy forms, benefits, etc. plus the grant of unlimited regulatory power to the Federal Insurance Administrator. Public hearings were held in early September at the conclusion of which Senator Brooke stated that no further action would be taken by the Senate this year. Contrary to the approach taken by the Justice Department, Senator Proxmire concluded his remarks by indicating that the burden of proof clearly rested upon the proponents of Federal regulation to show that state regulation has been inadequate.

I mentioned earlier that the other major arena in which the state vs. Federal regulation battle is heating up is ERISA (Employee Retirement Income Security Act of 1974) preemption. ERISA is commonly referred to as the "pension reform act" and in the early days after its passage, little attention was paid to its welfare benefit plan impact. Now that most of its pension provisions are getting resolved, growing attention is being paid to a very short section (Section 514 to be specific) which, depending on interpretation of its rather ambiguous terms, could render inoperable the existing and vast network of group life and health insurance regulation. The insurance industry finds itself in between a rock and a hard place on this issue. On the one hand, you have the industry's largest and most influential policyholders urging Congress to interpret ERISA preemption as broadly as possible -- while on the other hand, you have the insurance regulators actively urging Congress to make a very narrow interpretation.

It appears to this observer quite unlikely that Congress will take any action in the near future to clear up the ERISA controversy. Apparently, others feel this way too since an increasing number of court cases have begun to spring up all over the country. As might be expected, the judicial opinions being rendered in these cases also are inconsistent -- a New Hampshire judge comes down in favor of "narrow" preemption while in Indiana and California the judges chose "broad" preemption. It appears inevitable that within the next year one or more of these cases will be appealed all the way to the Supreme Court.

In conclusion, I would say that the potential for greater Federal regulation of the life and health insurance business is growing. Hopefully, wherever the regulation comes from, it will assure the greatest possible financial stability and the highest quality of protection for the public.

MR. IAN M. ROLLAND: I do not have an automatic reaction against regulation by the Federal government and in favor of regulation by state governments. There are obviously regulatory duties which can be handled better by the Federal government than by state governments. In fact, when I was asked to serve on this panel, I thought I would probably speak out rather positively in favor of increased Federal regulation of the life insurance business. However, further thought, study, and discussions have led me to believe that the industry should not try to promote further federal regulation of business. Instead, we should come out strongly in favor of strengthened and improved state regulation, and we should seek out methods of self-regulation particularly in the marketing area where unfair practices can create demands by the public for more regulation.

The underlying goal of the industry should be to promote the most efficient and effective regulation for the protection of the consumer irrespective of who is to be the regulator. From the point of view of consumer advocates, the real goals of regulation are consumer satisfaction and the accommodation of social changes. It seems to me that there is nothing incompatible between the objectives of the industry and the objectives of consumer groups in this regard. We will both benefit from effective regulation of our business.

In considering whether the industry should support federal regulation, there are several basic questions that need to be addressed:

1. Do we want to supplant state regulation and is this really possible? I think we have to recognize the fact that state regulation is in place, and deal with that reality in determining what form regulation ought to take. If we could start from scratch with no regulation at all, we might come to a very different conclusion about what sort of regulation is appropriate. States certainly have a powerful and legitimate interest in the protection of their citizens in the marketplace. Attempting to deny them that right would raise very difficult legal and constitutional problems. Thus, it is most likely that any system of Federal regulation would be imposed in addition to the already existing system of state regulation. The result would be more and probably less efficient regulation for our business.

2. Which aspects of regulation would we want to transfer to the Federal government? Solvency? Market conduct? Policy form approval? This would be very difficult to decide.

3. What part of the Federal government would we wish to have regulate us? The Securities and Exchange Commission (SEC), Federal Trade Commission (FTC), Justice Department, or the Internal Revenue Service (IRS)? We already have all these agencies to some degree as well as several others. Would we favor a brand new bureaucracy? However, could we create a new agency and remove all the other agencies from their regulatory oversight? This is not likely. Even if we could, would the Federal insurance department be regional in nature or a centralized Washington agency? If it was regional, how would we prevent the lack of evenhandedness and uniformity which we now perceive as weaknesses in the current state regulatory system? If there was a centralized bureaucracy, would we be willing and able to live with its inflexibility?

4. How would taxation be handled? Certainly, the states are not going to give up the tax revenues coming from our industry, and it is very difficult to separate the question of taxation from regulation.

While speaking in favor of the continuation of state regulation, it is highly important to add that we are not satisfied that the present system adequately serves the needs of the consumer or the industry. It needs substantial strengthening and improvement. There are glaring weaknesses in it. And it is those weaknesses which, at least in part, give credibility to the notion of Federal regulation. First, there is an unevenness and a lack of uniformity in state regulation which is not reasonable and which is not justified by local differences. There are too many instances where a state wishes to exercise its independence; as a result, national companies have to deal with regulatory differences which only serve to increase the costs of doing business with no apparent benefit to the consumer. Second, because of traditionally meager budgets, state insurance departments have found it difficult to attract and hold people who have the knowledge and experience necessary for regulating a complex business. Third, there is also a lack of ability on the part of the states to regulate effectively certain interstate activities such as mail order business, advertising, and group insurance. Fourth, too great a proportion of the regulatory effort is directed at companies which are financially strong while too little attention is given to the weak and financially troubled companies. I am concerned here by the cumbersome, expensive and inefficient examination system where state examiners spend untold hours examining the largest companies where little or no risk of insolvency exists and at the same time fail to detect insolvencies until it is too late. Finally, there is a growing tendency of states to adopt poor regulation out of fear of Federal intervention. A prime example is the variable life regulation which has contributed to the demise of a product which ought to have been offered to the public on a more widespread basis. That regulation is a hodgepodge of ill-conceived controls on marketing and pricing that were written for the most part on the forlorn hope that the SEC could be kept out of the act of regulating that product. All of these are real weaknesses that need careful and immediate attention. Both the industry and the state regulatory authorities need to work together to find solutions.

There are a number of ways in which the industry can assist.

1. The industry should seek to strengthen the NAIC so that the problems of uniformity can be ameliorated. States should be encouraged, particularly by Commissioners, to adopt uniform regulations and laws as written by the National Association of Insurance Commissioners (NAIC) unless there are strong reasons for making changes.

2. The industry should actively support more adequate budgets for state insurance departments and should insist that the states offer sufficient salaries and opportunities so as to attract competent people.

3. The examination system should be modified so that financially troubled companies can be detected at an early date, but the unreasonable burdens of the present system should be lifted from companies which represent no danger to the public.

4. Possibly, the most important role that the industry can play in strengthening regulation would be to adopt a form of self-regulation. This may require Federal legislation in order to solve anti-trust problems, but I believe it holds out the best possibility for avoiding a growing nonproductive interference in our business by regulatory agencies at all levels. This self-regulatory concept should deal primarily with our marketing activities. I think most of us would admit that too often companies are willing to tolerate less than adequate treatment of consumers and policyholders on the part of our sales organizations. This self-regulatory mechanism could possibly work under the oversight of the NAIC. It would be very similar in nature to the National Associaton of Securities Dealers (NASD), which has, in my opinion, very effectively regulated the sale of over-the-counter securities. This system would involve in part the qualification of agents, adoption of a code of fair practices for our sales people, the development of standards of suitability for sale of our products, and possibly some mechanism for enabling consumer

> advocates to have some input into our policymaking. This form of self-regulation would have to be tough and oriented to the protection of the consumer, but we would be doing it ourselves and thus it would very likely also take into account the legitimate needs of the industry.

In summary the question of whether the industry should promote Federal regulation is not new. We have on at least two occasions in the past tried to promote Federal regulation only to find that Congress had no interest in the subject. One must remember that in any political system the entities that have the power do not give up that power without a significant struggle. The states are not going to walk away and leave the regulation of our business to the Federal government. It is difficult to argue that this would be in the public interest or even in tune with the times. Therefore, our best approach is to support strengthened state regulation and at the same time, seek to temper and give rationality to the inevitable increase in Federal regulation.

MR. WILLIAM A. WHITE: I have been asked to comment on topic 3 of our program, the cost of state regulation. This is an elusive figure to arrive at with any accuracy since published figures tend to be somewhat outdated and since a large portion of the cost of regulation is internal to insurance companies and, hence, never identified. With these cautions I will pass along what information I have.

The insurance industry committee of Ohio annually compiles and publishes information about the finances and essential statistics of 51 United States insurance departments, together with comparable data for the three territories -- Canal Zone, Puerto Rico, and Guam, as well as for Canada and its provinces. The most recent report, which was released earlier this year, was for the year ending December 31, 1974. The essence of the report is contained in a single tabulation with eight columns showing the numerical information for each state.

For our purpose, the critical figure is column (6), funds spent for the operation of the insurance departments. For the year 1974 this figure was $92.2 million. The average figure per department was about $1.75 million. The median cost was just under $1 million. This obviously implies a skewed distribution. It is interesting to note that 61.1% of the cost of operating the insurance departments was consumed by the 10 largest departments in terms of operating costs. In order those are, of course, New York, Texas, California, Pennsylvania, Illinois, Massachusetts, North Carolina, Florida, Kansas and Michigan.

We can derive a couple of related figures from these. $92.2 million was the cost of all regulatory activities of the insurance departments. In an effort to find out what part of this might be directed to the life insurance industry, I sent letters to a number of regulatory actuaries. All of these actuaries had the same difficulty I did in the New Jersey department coming up with an allocation of cost but the consensus seemed to be that somewhere between 35% and 50% of the costs of operating an insurance department are devoted to life insurance activities. Conversely, this means that somewhere between 50 to 65% of the activities of any insurance department do not affect the life insurance industry at all but are involved with property and casualty operations and service corporations such as Blue Cross and Blue Shield. Since these are 1974 figures, we need a projection factor to bring them up to 1977. In my experience, states have been tight on their expenses in the

STATE INSURANCE DEPARTMENT STATISTICAL DATA
YEAR ENDING DECEMBER 31, 1974
COMPILED BY THE INSURANCE INDUSTRY COMMITTEE OF OHIO

STATES	LICENSED COMPANIES	PREMIUM VOLUME ALL COMPANIES	PREMIUM & OTHER TAXES CERTIFIED	FEES COLLECTED	TOTAL TAXES & FEES	FUNDS SPENT FOR OPERATION OF DEPT.	PERSONNEL	
							TOTAL (inc. examiners)	EXAMINERS
Alabama	986	$ 1,648,252,839	$ 35,128,855	$ 1,071,358	$ 36,200,213	$ 1,269,730	60	14
Alaska	697	189,637,550	4,420,055	265,367	4,685,422	284,100(2)	11	0
Arizona	1,420	1,008,706,728	19,588,619	835,479	20,424,098	733.895(2)	72	19
Arkansas	1,005	743,920,672	13,354,034	515.746	13,869,780	671,367	45	7
California	1,064	10,518,791,000	203,207.050	4,038.917	207,245,967	6,990.857	308	52
Colorado	1,085	1,203,856,274	20,312,235	725,967	21,038,202	940,068	58	16
Connecticut	594	1,453,133,220	34,299,462	1,129,945	35,429,407	971.462	67	21
Delaware	924	277,154,574	5,266,367	146.158	5,412,525	207,359(2)	19	0
Dis./Columbia	809	425,000,000	8,500,454	238,597	8,739,051	467,000	22	6
Florida	1,086	3,929,840.474	57,126,316	-	57,126,316	2,965,168	150	12
Georgia	1,043	2,250,000,000(1)	37,559,714	1,111,847	38,671,561	1,260,930(2)	90	0
Hawaii	534	329,370,474	9,886,239	1,890,444	11,776,683	322,441(2)	24	1
Idaho	905	364,084,861	7,732,253	381,521	8,113,774	299,141(2)	19	0
Illinois	1,414	6,041,055,071	55,664,641	6,205,230	61,869,871	4,093,356	235	51
Indiana	1,240	1,800,000,000(1)	35,884,602	320,265	36,204,867	855,693	65	18
Iowa	1,160	1,441,460,394	23,827,734	759,410	24,587,144	764,768	40	25
Kansas	905	970,848,871	18,350,616	1,062,459	19,413,075	2,795,212	127	12
Kentucky	959	1,317,951,398	18,672,460	781,549	19,454,009	1,000,000(1)	68	8
Louisiana	1,183	1,638,259,340	28,270,172	-	28,270,172	943,749	54	9
Maine	685	393,567,576	7,041,140	401,502	7,442,642	408,171	26	5
Maryland	812	1,899,033,082	30,787,655	943,950	31,731,605	1,514,728	93	12
Massachusetts	685	3,017,839,798	72,161,834	3,162,346	75,324,180	4,075,014	325	170
Michigan	945	5,319,871,562	68,991,016	3,412,184	72,403,200	2,719,800	133	27
Minnesota	1,126	1,989,870,079	32,054,871	1,524,109	33,578,980	797,747	49	20
Mississippi	1,176	822,622,913	21,776,702	563,348	22,340,050	725,751	54	0
Missouri	1,125	2,504,956,978	35,849,523	1,655,364	37,504,887	2,171,471	85	46
Montana	955	294,246,426	7,724,952	598,265	8,323,217	366,842	17	2
Nebraska	920	782,018,951	12,409,876	712,049	13,121,925	728,102	58	17
Nevada	856	250,246,846	5,465,335	678,724	6,144,059	927,330	50	13
New Hampshire	653	397,600,495	6,265,686	619,437	6,885,123	386,671(2)	30	0
New Jersey	820	4,260,340,280*	51,799,000	2,099,654	53,898,654	2,450,011	172	22
New Mexico	957	425,378,779	9,204,523	819,494	10,024,017	371,015(2)	30	0
New York	751	12,522,872,707	152,467,922	15,182,869	167,650,791	15,657,164	638	210
North Carolina	859	2,177,104,841	47,360,876	1,126,082	48,486,958	3,198,003	183	28
North Dakota	872	233,279,700	4,923,738	251,638	5,175,376	228,440	19	3
Ohio	1,154	5,150,434,789	81,762,464	2,066,093	83,828,557	1,939,486	96	21
Oklahoma	1,121	1,148,170,320	33,661,360	-	33,661,360	823,238(2)	49	0
Oregon	1,000	1,507,566,380	16,481,388	776,760	17,258,148	998,505(2)	51	7
Pennsylvania	1,112	5,385,391,000	88,173,296	2,953,392	91,126,688	4,531,858	232	46
Rhode Island	703	472,932,532	8,565,888	311,480	8,877,368	266,852	22	7
South Carolina	896	1,077,326,127	20,956,310	1,543,492	22,499,802	1,680,740	106	13
South Dakota	868	250,943,576	6,096,029	200,400	6,296,429	238,377	18	4
Tennessee	973	1,807,058,737	34,366,562	4,110,962	38,477,524	1,269,756	93	17
Texas	1,724	5,757,183,842	97,881,104	3,928,025	101,809,129	9,364,202	587	45
Utah	980	470,321,871	8,946,234	535,638	9,481,872	459,198	23	6
Vermont	563	265,385,506	3,591,130	126,344	3,717,474	170,759	15	0
Virginia	1,014	2,037,724,671	47,679,969	388,123	48,068,092	1,054,983	70	13
Washington	1,051	1,581,442,968	22,615,055	608,638	23,223,693	2,096,217	120	18
West Virginia	807	625,461,040	15,457,153	300,367	15,757,520	601,800	51	2
Wisconsin	1,082	2,301,059,417	26,525,511	1,474,734	28,000,245	1,679,681	84	27
Wyoming	805	126,329,711	3,197.655	155.619	3,353,274	356,968	19	4
				Totals...	$1,794,004,976	$92,171,167		
TERRITORIES								
Canal Zone	57	$ 14,093,143	$ 211,903	$ 570	$ 212,473	$ -	-	-
Puerto Rico	265	341,060,863	6,942,571	542,388	7,484,959	755,212	67	11
Guam								
CANADA AND PROVINCES								
Dominion of Canada	431	5,822,719,811	-	-	2,071,000	2,481,000	113	37
Alberta	333	492,632,903	7,289,527	232,551	7,522,078	417,176	33	3
New Brunswick	277	136,804,117	2,524,803	35,072	2,559,875	116,175	5	0
Newfoundland	209	87,920,423	-	54,000	-	-	4	2
Nova Scotia								
Ontario								
Prince Edward Island	194	1,416,756	2,716,990	86,313	2,803,303	-	2	0
Saskatchewan	312	226,993,104	4,303,917	186,310	4,490,227	247,139	21	2
Quebec	720	2,110,879,912	40,391,801	291,071	729,992(3)	938,181	60	12

*Property and Casualty Premiums Earned
-Information Unavailable
(1) Estimated
(2) Does not include examiners salaries and expenses

Information unavailable for Guam, Nova Scotia and Ontario

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last three years. I would guess that a 10% annual increase or a 30% total projection factor would probably put us in the ball park for 1977.

Now as to the hidden costs. These represent the expenses incurred by companies in order to comply with regulatory requirements. Probably the most obvious form of hidden cost is the expense incurred by a company in connection with its triennial, quadrennial, or quinquennial examination. I had a very rough estimate from one substantial company domiciled in New Jersey which is presently undergoing a quinquennial examination. The figure that we had from them (which may be high) is that they spent about $3 internally for every dollar that they pay the insurance department for examiners' salaries and expenses. Of total magnitude, they estimated it cost them about a million dollars internally to conduct an examination for which they pay the state of New Jersey about $350,000. Putting the figures together, we can project that the total cost for state regulation applicable to life insurance companies during the year 1974 was about $100 million.

I compiled a book of statistics and information during the last six weeks to prepare for this discussion. On the assumption that we are going to have a lively spirited interchange of thoughts, I would just like to tell you some of the results.

I sent a letter to each of the regulatory actuaries that I could identify. The 12 replies I received were carefully thought out and in some cases surprising. The three questions of opinion asked of all the regulatory actuaries were:

1. What are your opinions on the advantages and disadvantages of Federal as opposed to state regulation in the areas of life and health insurance?

2. If there are advantages to Federal regulation, could these advantages be achieved by means of changes in the state regulatory system through organizations such as the National Association of Insurance Commissioners?

3. From what you know of the Canadian regulatory system, could such a system be established in the United States, and if so, how would its effectiveness compare with the effectiveness of our present regulatory system?

In discussing Federal models, one of the problems is that we are discussing something that is completely unknown to the United States. The reactions seemed to be to the worst possible sort of Federal regulatory mechanism that could be established.

I have heard glowing reports on the Canadian regulatory system, and in order to elicit more information concerning that system, I wrote the Dominion of Canada insurance department and got an extremely detailed response describing the present pattern of Canadian supervision, some of the historic perspective, and also comments on the effectiveness of Federal regulation.

The third section of this book is the late lamented Institute of Life Insurance Project 3, which was widely heralded, loudly praised, and quietly aborted back in 1972. A portion of that project was the report of the Committee on Regulation and Corporate Structure. The thrust of their recommendations was to establish a system of national (as opposed to Federal) regulation with a greatly strengthened central NAIC operation.

MR. ROBERT L. PAWELKO: I spent four years in the Illinois Insurance Department. I can agree with Mr. Rolland's comment that we should give more money to the insurance departments to help them. Truthfully, during my four years there money was never my concern. I felt that I was compensated adequately during that time, even though there were limits on compensation. I left the Illinois department because of a political change and a philosophical change at the top. The same thing occurs in a company when a new president takes over. There is a philosophical change in the company and there may be personnel changes because those who do not agree with the new philosophy depart.

I am not overly concerned about the amount of money that goes into insurance departments. It can always be increased. The problem is that the more money you give anybody, the more that is spent. I do not think lack of money is really the answer. I would rather see the companies who are regulated and those people who are in the companies, from the top levels all the way through, show more interest in the insurance department. I would like to see them visit the department as well as express an interest during a gubernatorial election. Make sure that you get a good insurance department. When I was in the Illinois department I saw all kinds of lobbyists and all kinds of people down at the insurance department when it came time to protest a bill that was directly affecting their company. But, nobody was ever lobbying for a good actuarial staff or was really pushing for a good Commissioner of Insurance. Spend some time and effort in building a good insurance department. That is my one real criticism of the insurance industry: no one is interested in working at building an insurance department.

I wish to ask this group to answer the question: What is the real advantage of Federal regulation? Is there any real carrot for the industry? And if there is a carrot is there a club right along side of it that would negate the value of the carrot? I have a hard time seeing any advantages. Does anyone here see any real advantages?

MR. ROLLAND: Well, I did not speak in favor of Federal regulation but I think certainly one of the advantages that a lot of people see in Federal regulation is the uniformity that will overcome the significant difficulties in dealing with fifty different state insurance departments which all have different ideas. It is a very cumbersome process when each one of those states goes off in a different direction. There is also a reaction of companies to incompetence (I hate to use the word incompetence, but I guess you really have to get down to that). A lot of people have to deal with state departments that do not understand our business, and as a result the regulation often times comes out of a sense of ignorance. I think those in favor of Federal regulation see it as an opportunity for even handed treatment and uniformity as well as the opportunity to obtain competent people to do the regulating. I have had the experience of dealing with the SEC in the variable annuity area. I certainly got uniformity. We were also dealing with competent people who were interested in the business. You ask whether there is also a club that goes with that. I think certainly there is. Since you are dealing with only one regulator, that regulator has the power to control business all over the country and impose his will by stating: This is the regulation.

MR. RICHARD A. BURROWS: Uniformity certainly is an advantage, but more important is responsiveness. I think you were in that area when you talked about the SEC. With the one body (Mr. Pawelko, I am going back to what you said about lobbying or supporting a good staff), at least you can concentrate your efforts to get responses. In one recent instance, a company actuary, prior to his resignation, refused to sign a statement blank in 50 jurisdictions and there was no action taken because of this. Now, how much can an actuary professionally protest the management of his company and yet have nothing happen? Maybe I am putting some people on the spot here since we have several people from the state departments, but what happened in that situation? The club may be a disadvantage, but at least you can direct yourself -- you can respond to it.

MR. PAWELKO: I am not sure what situation you are talking about. I know of one incident when I was in the Illinois department where an actuary of a very large company refused to sign an annual statement and I. found out about it right at the front end. I put in about six months of very extensive study on the whole situation. Fortunately, it was a health company. The problem was health-related and President Nixon saved the company by asking for the wage-price freeze. Since hospital costs could not increase, the inadequacy of the claim reserves worked itself out during that time. If that is the same situation you are referring to, I agree with you -- it is very frustrating. I knew about the problem. I had talked to other insurance department actuaries. I do not know if we could have reacted to do anything or not. Since the company was able to work out its problems we tempered a lot of the action we were prepared to take.

Everybody wants you to take action the instant it happens. During the time I was in the insurance department, I would get probably three or four telephone calls in a year telling me there was something wrong with some company. When I received such a call I reacted as best I could. I would contact different consultants with whom I had business relationships and who I knew would contact other actuaries of other companies. I was as discreet as possible. I did not trust the insurance examination system of the various departments, because, by and large, the companies with the problem had managed to wire themselves into the political structure of the state and the examination reports did not show that. Frequently when an examiner's report indicates a problem on a company, there is a long extended period before that report becomes a public document. So I went to as many outside sources as I possibly could.

I think the mechanism is there in the states, if the state people were supported by enough people like yourselves. Come in and talk to us once in a while and offer your support. I do not think that going to the Federal government is going to change reactions. I do not think we will have any improvement.

I am working now in the pension area more than in the life area, and we have a Federal agency called the IRS. I do not know if any of you ever tried to get a determination letter from the IRS on a pension plan but I have had pension plans copied verbatim, one client to another, submitted to the same IRS district office and have a determination letter come back on one but not on the other. Federal government agencies, just like state agencies, are run by people, and people in the Federal government are no different than people in the state government. So, those problems are not going to change just by switching from a state system to a Federal system.

We already have in place an agency that could serve as a central regulatory body: the NAIC central office. It is very similar to the NASD -- it is funded by the various state insurance departments. It could be a regulatory vehicle if it was staffed with ten or fifteen good actuaries, maybe including seven or eight casualty actuaries, along with a couple of good attorneys and CPA's. In fact, why not make that the examination operation. It could be a mini-consulting firm for the states. The states could take their current revenue, put their own people into that office, transfer them to it if they wish. That is the advantage that the Canadian system has: being under a good solid, singular authority. With that structure, you can train people. But, by and large, regulators are just like you and me and the people who work for you. They could be trained to get the job done, if you exert the effort. I think the NAIC central office is the answer.

MR. BRADFORD S. GILE: I am pessimistic about uniformity in going to the Federal system -- Mr. Pawelko's remarks on treatment of pension plans by the IRS in getting determination letters is one illustration. Another would be the life insurance tax office of the IRS. Actuaries have had to sit down and explain to the tax auditor reserves that have been traditional for many, many years, such as the nondeduction reserve, and each time it was shown to the auditor, he would say, yes, this is a life reserve and we can use it. I do not really think that you are going to find uniformity even in a central agency. Now, as to getting a centralized regulatory body in the NAIC, this idea has been proposed by several people. For example, the American Council of Life Insurance (ACLI) proposed cooperation in valuation and nonforfeiture value regulations. There is a strong political problem in getting the NAIC to do this. Several commissioners would strongly oppose any attempt to take away their sovereignty as they see it. The answer lies not so much in getting NAIC central to beat the Federal government, as it is in going to your individual insurance departments and beefing them up.

MR. DONNELLY: My comments are going to be directed primarily in an area called group insurance since that is my expertise -- but I see a problem. We have talked about the NAIC. Within the group insurance business we do not necessarily view the insurance departments as the primary source of our problem with regulation. I say our primary source. The problem now -- the growing problem of recent days -- is that the legislatures of the states are becoming heavily involved in regulation. I believe you will agree that the Wisconsin legislature has been passing bills, and that it is not necessarily the insurance department itself which regulates. We may have a good relationship with a competent insurance department; the problem is to have legislatures that are willing to take on the public interest factions who decide that insurance should meet all sorts of social needs. This is impacting directly on group insurance plans which obviously are written outside Wisconsin or any particular state and extend into Wisconsin. Legislatures decide to apply laws extra-territorially to protect their own residents, and rightfully so maybe, but it impacts upon a particular line of business.

Mr. Gile, can you comment on the impact that state legislators are having on the business of insurance -- particularly in Wisconsin?

MR. GILE: Well, there is no doubt at all that the legislature has a very direct impact in Wisconsin. The insurance department is a part of the executive branch of the government -- it is not a quasi-judiciary body.

MR. DONNELLY: You implement what the legislature decrees and your statement about insurance departments not having that much control is the nature of my comment: the NAIC central office may be able to exert a little more control on uniformity, but where do we get the control of the state legislatures and what they are doing?

MR. PAWELKO: When I worked in the Illinois department, we controlled the legislation that came through. Bills that were introduced in the legislature had to be cleared by the insurance department before they could go back to committee and before the legislature could even vote on them. Legislation had to come to the department. Since the executive branch has the final authority on the bill they would send it back to their own staff, namely the insurance department. We could have stopped some bills if we had some decent staff. If any department has decent staff, it can stop legislation.

FROM THE FLOOR: What do you do to block the governor's proposal on some rather silly insurance legislation?

MR. PAWELKO: Voting him out of office is all you can do in that situation. The best answer to the problem would be get involved directly with the departments. Send the good people in your company. Do not send a lobbyist who really does not understand what he is lobbying for and is just paid to go out there and wine and dine someone. Take time and energy to do it yourself. That really is the key. When I was a regulator, I really appreciated it when an actuary or a top level executive came down and talked to me about a problem. It was much better than having him go through an attorney who happened to know somebody in the department. It is much more effective. So, maybe the answer is to get involved with the governor and tell him where he is causing the problem. If he realizes that you have 10,000 employees working for you and those 10,000 employees have agents who know another 10,000 people the governor will think twice.

FROM THE FLOOR: Would it be a good idea if it was mandatory for all legislation to pass through the insurance department?

MR. PAWELKO: I think people will argue on that. However, in my opinion, all states should have such a mechanism already. The governor must sign a bill to make it a law. He can rely on his executive branch agencies. If he does not understand the bill he can table it until he does understand it. We had people assigned in our department to know exactly what was happening in our legislature. I think other departments can do that.

MR. LESLIE MAINE: Mr. Rolland, I am interested in the idea of self-regulation, but I see some problems that already exist, and I wanted your opinion on how we could handle the problems under a self-regulation approach.

I work in the direct response department. One of the problems we see right now with state regulation is that there are certain states that seem to be dominated by lobbyists who have insurance agents' interests in mind but not too much of the consumer's interest. Therefore we have a very difficult time operating in those states and sometimes it is almost impossible. Now I do not want to get into whether this is indeed better or worse for the consumer but I question how a self-regulation approach by the insurance industry will avoid this type of problem. How are you going to prevent the large mutual companies from keeping the status quo? Will their interest be self-preservation or the consumer's best interest?

MR. ROLLAND: The reason I am promoting this idea and think it is a good one is because of my experience with the National Association of Securities Dealers (NASD). I was on their Board for three years and saw it operate. In my view it operates very effectively. It is a self-regulatory organization, of course, operating under the oversight of the SEC, but the Board of the NASD consists of people elected by the industry, and the regulations are carried out by those people. In some ways I think it is stronger regulation than would come from people working full time in the regualtory area, since the part-time regulators are committed to making sure that business operates for the good of the consumer as much as possible. They take their regulatory role very seriously.

And so certainly any such organization like that which would spring up in our business would have to involve people who would look beyond the parochial interest of their own particular companies. They should want to create a marketplace where consumers and policyholders are treated fairly, but, at the same time, where the legitimate needs of the insurance companies are addressed in forming the regulation. It has a fair possiblity of working, although I agree that there would have to be some type of governmental oversight over the activities of that organization. And I suggest it might be a strengthened NAIC office or maybe some new organization would have to be formed. If we set our minds to it, we can do a better job of regulating our marketplace and the way our agents do business than people that are not working day to day in the business.

FROM THE FLOOR: What are the possibilities of joint state and Federal regulation?

MR. WHITE: My present leaning is towards the strengthened centralized NAIC office approach, although I share Mr. Gile's concerns that the insurance departments are every bit as big empire builders as any of the departments of any of the insurance companies. The insurance commissioners are very reluctant to relinquish any authority. The almost unanimous opposition of the insurance commissioners to the Brooke bill is an indication of knee-jerk reaction. The NAIC and the central office tend to be very state's-rightest. I disagree with Mr. Gile when he suggests that the individual departments can be strengthened to accomplish the same degree of effectiveness as would a centralized NAIC office or Federal mechanism. What we would in effect be doing is inventing the wheel 50 times. One of the problems with the present state mechanism or an augmented state mechanism, is the almost total lack of communication between the departments. So whenever each of the dozen or so actuaries working for a department (other than New York) is faced with a problem, he is in the position of trying to solve that problem on his own, without the benefit of the analysis or the suggestions of other regulatory actuaries. A good concept of a centralized office would be to bring together a number of actuaries (as in Canada or New York) so that the actuaries can interact and can parcel the technical problems out among themselves and to an extent buffer themselves from the trivial problems that seem to consume a lot of time of the actuaries in the individual insurance departments.

It might be interesting if I were to read just the short list put together by the Institute of Life Insurance Project II on the common elements of an ideal regulatory structure. The common elements are ten:

(1) minimum overlap

(2) ability to anticipate and respond to new environments

(3) elimination of trivia

(4) effective enforcement

(5) the right of appeal

(6) a dialogue between the regulators, the regulated and the public

(7) non-discriminatory regulation, in and out of the industry

(8) permit experimentation

(9) consistency of regulation and enforcement

(10) general acceptance.

The recommendations were 9 in number and almost as brief. This list was made to justify the primary recommendation of the Project for the establishment of a coordinated state supervisory structure in preference to either independent state action or Federal control. Reasons supporting the recommendation were:

(1) it is possible

(2) historical precedent, and body of law already exist

(3) the evolutionary process is simpler than the revolutionary process

(4) the coordinated structure is potentially more flexible

(5) it is extremely unlikely that sole Federal regulation is possible, therefore, a move to a Federal regulation would merely increase the problems of overlap by having both Federal and state supervision

(6) there are existing areas of expertise currently at the state level which do not exist at the Federal level

(7) the majority of life insurance executives still favor state regulation over Federal regulation

(8) better opportunity for dialogue

(9) the lines of communication are already established.

I have an additional comment on Mr. Rolland's suggestion for self-regulation. As the cynicism in me surfaced I asked myself how does this differ from the present mechanism? The second point that occurred to me is that in today's political consumerist climate, one of the buzz phrases is "sending the fox to watch the chicken coop"; for this reason, it is very unlikely that his idea of self-regulation would be politically saleable.

MR. ROBERT J. CALLAHAN: Mr. Pawelko, is part of your opposition to a Federal regulatory agency due to your personal experience in working for a state agency?

MR. PAWELKO: No. Most of my opposition to Federal regulation boils down to my pocketbook; I pay enough in taxes already and I cannot see paying more taxes to superimpose another regulatory agency over the current structure.

FROM THE FLOOR: You mentioned the lobbyists for the Illinois Department who wined and dined legislators. What is your feeling about the December and June meetings of the NAIC with the open bars and a great deal of wining and dining of the insurance commissioners by the insurance industry?

MR. PAWELKO: I think I might have been misread by that. My comment was not against the concept of wining and dining, per se. My problem is with the people who do the wining and dining. I have no objection to having a drink with anyone. I object to having a drink with a lobbyist who represents 15 companies but who really does not understand the issues. My suggestion was really to stir you into getting the right people to do lobbying. Lobby with effective people. Bring your own people in instead of a paid lobbyist.

FROM THE FLOOR: Mr. Pawelko, you mentioned that you are strongly in favor of an NAIC central office with perhaps 15 actuaries. This idea was discarded two years ago because the states wanted to preserve their own political jurisdictions. Instead a valuation of non-forfeiture benefits task force was established to act as a central guidance body. Mr. White, since you are a member of that task force, what are your feelings about that idea for trying to get some uniformity?

MR. WHITE: The task force that has been set up within the NAIC on non-forfeiture and valuation is not significantly different from any of the other actuarial task forces that have been set up during the last 70 years to establish uniform legislation. I have not been able to attend the task force meetings in the last couple of years, but I think the task force is a good example of the defects of state regulation: the inability of professional people to address themselves with any concerted cooperation to major problems of the life industry. The task force is able to meet two, three, or four times a year, and the bulk of the work is done by one man. The progress of the task force is agonizingly slow, the directions of the task force are almost invariably being dictated by the industry advisory committees. I cannot help but feel that if we had a Federal regulatory mechanism, composed of all of the actuaries that are presently in regulatory work, isolated, devoting themselves to genuinely actuarial problems in Washington, Albany or wherever, we would have had answers and we would have had better answers a couple of years ago, on a matter like the changes in valuation and non-forfeiture law.

MR. PAWELKO: I was on the Unruh committee which wrote the report on the non-forfeiture law and we discussed this in detail and we came to the conclusion after many meetings that the centralized body concept made sense and we picked the NAIC central office. The fact that the idea was discarded two years ago does not mean it is a bad idea.

MR. ROLLAND: It is important to keep in mind that there is more to this business than the actuarial aspects. We need competent marketing people who understand what is going on in the marketplace, and competent actuaries. In addition, we need competent people that understand the insurance business in a broad sense.

MR. WHITE: Mr. Pawelko has posed a question which is purely in the actuarial province and for that reason it is probably more appropriate in the end. This leads into a discussion of the item that we deliberately ignored on today's program: How would actuarial work differ under a Federal structure? I think I find myself in 100% agreement with Mr. Pawelko. As a professional actuary faced with professional responsibilities, I find it extremely difficult to operate in what is effectively a one man shop, wrestling with about 75% trivial problems. I feel very remiss as an actuary with the contribution that I am able to make to a major project like the revision of the non-forfeiture and valuation laws. What input I have had has generally been superficial, hurried, and based more on impressions than anything else. And as a professional actuary, I would dearly welcome an opportunity to work with other actuaries and be able to devote professional quality thinking to major industry regulatory problems.

MR. HARWOOD ROSSER: There is some contact between the U.S. Labor Department and the NAIC and the state insurance department as witnessed in the multi-employer trust (MET) situation where the responsibility appears to be divided. There may be a regulatory vacuum to which promoters have rushed in. I am sure most of the states are aware of this MET problem.

The way the Department of Labor (DOL) has been dealing with ERISA shows a parallel problem with state insurance departments in over-regulating large companies and under-regulating small ones.

MR. WHITE: The opposition to Federal regulation seems to be for the most part an attempt to measure the ferocity of the camel whose cute pink nose is poking its way through the flap of our tent. Considering that plus the fact that Halloween is five days from now I checked with the local library for an old Cornish prayer which reads, "From goulies and ghosties and long leggedy beasties and things that go bump in the night, good Lord, deliver us."