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ADDRESS OF THE PRESIDENT, RICHARD C. GUEST

INSURANCE SUPERVISION

XIVth International Congress of Actuaries

DURING my term of office it was my privilege to attend, along with a number of fellow actuaries from this continent, the XIVth International Congress of Actuaries in Madrid. It was a most successful Congress. There were over 900 delegates as well as some 600 visiting ladies in attendance. The topics were stimulating; the discussions were thorough and spirited; the arrangements were most carefully planned and carried out. Professor Lasheras Sanz and his local committees are indeed to be congratulated upon an excellent affair.

I would be remiss indeed if I failed to express before this body, on my own behalf and on behalf of my colleagues, deep appreciation for the gracious hospitality extended to us in Madrid. Our visit to Spain was certainly pleasant and some of us made extended tours. A number of us who were there but a short time were taken on interesting sight-seeing trips in the surrounding area. We came away with an indelible impression of the depth of the history of that country and with a warm feeling of friendship and respect for our Spanish hosts.

Scandinavian Golden Jubilees

This summer each of two Scandinavian actuarial organizations celebrated its Golden Jubilee—Svenska Aktuarieföreningen in Stockholm and Den Norske Aktuarforening in Oslo. I was invited to attend or to send an official delegate of the Society of Actuaries to those happy celebrations. It was quite appropriate that Walter Klem should represent us, and it was fortunate that he was able to make the trip to Europe for that purpose. He carried the greetings of the Society of Actuaries and presented to each group an appropriately engraved silver tray as an expression of our good wishes and as a memento of the occasion.

INSURANCE SUPERVISION

Having spent all of my business life in insurance circles in the United States, I am prompted to look back and review factors that have kept the development of the insurance industry in this country a sound one. Undoubtedly the most important factor has been good management. As a matter of fact, the growth has been so rapid as to require extraordinarily resourceful management. Moreover, probably there is no other business in the United States which evidences a more outstanding sense of trusteeship than is shown in the insurance industry. I wish to discuss today another highly significant factor, governmental supervision, which has certainly played an important and at times vital part in the sound development of our business.

During my official visits to actuarial clubs in the United States and to the Canadian Association of Actuaries, I took the opportunity to ask provocative questions in the general field of insurance supervision and regulation. The keen interest shown in the subject by both American and Canadian actuaries has led me to take a closer look at insurance supervision in Canada and in the United States. This should be interesting since the two systems have developed in somewhat different environments and since in the United States the Federal government has not participated directly in the supervision of insurance whereas in Canada participation by the Dominion government in supervision dates back almost to Confederation.

At this point, I wish it understood that the company with which I am associated should not be considered as assuming any responsibility for the expression of these my own personal views. Also, I wish to express my indebtedness to my old friend, R. Leighton Foster, Q.C., for permitting me to use his published material in developing the historical background of the Canadian situation.

Canadian Supervision

Our attention will first be given to Canadian supervision. Years before the confederation of the provinces of Canada was consummated through the British North America Act of 1867, a tradition of provincial supervision of insurance already was being established. As early as 1836, Upper Canada was regulating mutual fire insurance companies; the Canada Life, a private company, was incorporated in 1847; the supervision of friendly societies was introduced in 1850; New Brunswick entered the field of supervision in 1856; in 1860 legislation called for the licensing of nondomestic fire companies; in 1865 there was enacted legislation related to life insurance itself.

Dominion Supervision

Although the British North America Act placed banking under Dominion supervision, no mention was made of insurance. However, in the year following Confederation the question was raised as to whether the jurisdiction of insurance affairs should rest in Dominion or provincial authority. For the time being, this highly political question was resolved by the enactment in 1868 of the first Dominion law requiring insurance companies, except local companies doing business within one province, to be licensed by the Minister of Finance. The Act established, for the time being, a division of responsibility between the Dominion and provincial authorities. Essentially this has survived to the present, although several revisions have been challenged in the courts. In this traditional arrangement, the Dominion licenses companies doing business across provincial lines and examines such companies as to their financial soundness, whereas the provinces supervise the more intimate details of the daily operation of the business, such as policy contracts and licensing of agents. Incidentally, as what might be considered an exception, the friendly societies were exempted from Dominion supervision by this 1868 Act.

By 1875 it became necessary to provide for a Superintendent of Insurance for the Dominion of Canada. The post of Dominion Superintendent was, and continues to be, a most important one and has been filled by outstanding career men. There have been but few incumbents, since each of these men has devoted a large part of his lifetime to the service.

Following the Armstrong investigation in New York in 1905 and resultant publicity and legislation, some uneasiness arose in Canada. On the recommendation of a Royal Commission appointed for the purpose, the Insurance Act of 1910 was enacted, substantially expanding the area of Dominion supervision. This attempted expansion was held invalid in 1916 as not being within the Dominion powers to legislate for the peace, order and good government of Canada or for the regulation of trade and commerce. A revised Act of 1917, attempting to reinstate an expanded area of supervision and making it an offense under the Criminal Code to operate without a license, was also held invalid in 1924 as not within Dominion jurisdiction over criminal matters. A further attempt was made in a 1927 Act to get an expanded area of supervision by imposing a particular tax on unlicensed insurers. This was held invalid in 1932 as an improper use of the power to tax.

As one result of this litigation, the original act, as amended, was replaced by three separate acts in 1932, the Department of Insurance Act, the Canadian and British Insurance Companies Act, and the Foreign Insurance Company Act. Broadly speaking, the object of this Dominion legislation was financial soundness. It involved for federally licensed companies complete and uniform returns to, and periodic examinations by, the Dominion Superintendent of Insurance. It delineated the permitted field of investment, it required the separation of accounts of participating and nonparticipating business, it called for the election of policyholder directors as well as shareholder directors and it limited the proportion of profits which might be made available to shareholders.

An interesting and most significant feature, which first appeared in the Act of 1927 and was continued in the acts of 1932, was the requirement that the actuary not only certify the valuation but also certify "that in his opinion the reserves make a good and sufficient provision for all unmatured obligations of the company under the terms of its policies." This enactment was a natural complement to the more flexible valuation standards permitted in the provincial Uniform Life Insurance Act of Canada and, incidentally, defined what constitutes qualification as an actuary in the eyes of Canadian law. The counterpart of this definition does not exist in the United States.

Provincial Supervision

In the field of provincial supervision, undoubtedly the most significant legislation so far enacted is the Uniform Life Insurance Act of Canada, which was approved by the provincial superintendents' association in 1923 and enacted in seven of the provinces within a year after its approval. Nova Scotia followed in 1925, and Newfoundland in 1931. Quebec stands alone as the exception. It was found next to impossible to adapt many of the features of the Uniform Act to the basic French code of law existing in the Province of Quebec. However, this has a strictly local impact, since that province does not undertake in any way to influence the conduct of the insurance companies outside the province. The original Uniform Act has rarely been amended and then only by uniform action of the provincial superintendents of insurance.

Canadian supervision might be considered as falling between two extremes: on the one hand, British supervision, involving a minimum of governmental intervention, placing great dependence upon the actuary, and relying to a large extent upon the use of publicity; and on the other hand, supervision in the United States, involving a great deal of legislative and regulatory restriction which seems to intensify with the years rather than diminish. The combined Dominion and provincial systems in Canada embody a somewhat detailed control of policy provisions, agents' licensing and other related matters, an adequate supervision of financial condition, characteristic British dependence upon the actuary, and, last but not least, a simplicity characterized by a high degree of uniformity.

It should also be noted that every attempt in Canada to sustain a nation-wide supervision of the more intimate details of management of insurance affairs in the face of an already existing system of local supervision has met defeat at the hands of the courts. Once the dividing lines as between Dominion and provincial authority to supervise were clearly drawn by the courts and the 1932 legislation, there developed a very happy interrelationship between provincial supervision on the one hand and Dominion supervision on the other.

Federal Government of United States Not Active in Supervision of Insurance

Turning now to the United States, we find a quite different situation. The Federal laws in the United States have been notably silent on the subject of insurance. The right of the Federal government to exercise supervisory power has hinged upon the answer to whether insurance is commerce and whether the issuance of a policy of insurance across state lines is interstate commerce under the Constitution. In *Paul v. Virginia* (1869) insurance was adjudged by the United States Supreme Court not to be commerce, and for seventy-odd years that decision stood. As a result, during that period insurance companies were not subject to Federal supervision except through such regulations as applied to all employers under Federal social programs. In the *South-Eastern Underwriters Association* case decided on June 5, 1944, the Supreme Court reversed the early decision in *Paul v. Virginia*, holding insurance to be commerce, insurance transactions across state lines to be interstate commerce, and the insurance business to be subject to the Sherman Anti-Trust Act. In the *Polish National Alliance* case, decided the same day, the court held the insurance business to be subject to the National Labor Relations Act and by implication the business became subject to other Federal statutes, among them the Fair Labor Standards Act of 1938, the Clayton Act, and the Federal Trade Commission Act.

These two decisions resulted in confusion and some alarm as to their impact upon state supervision. However, after extended hearings, Congress enacted the McCarran Act, Public Law 15 of the 79th Congress, effective March 9, 1945, containing a declaration that "the continued regulation and taxation by the several states of the business of insurance is in the public interest," but making the insurance business subject to the Sherman, Clayton, and Federal Trade Commissions Acts "to the extent that such business is not regulated by state law." The Act further provided a moratorium period which was subsequently extended to June 30, 1948 in order to allow necessary time for states to make readjustments in their anti-trust and rate-regulatory laws. In effect, except for certain limited areas of Federal jurisdiction, state supervision was given an indefinite period of extension with a minimum of Federal interference. It is perhaps not surprising that the Congress hesitated to interfere at such a late date with the supervision of insurance. Moreover, the National Association of Insurance Commissioners presented a united front in support of the continuation and improvement of state supervision. Presumably, lacking any basic philosophical or social change, there need only be a thoroughly practical, effective, and generally reasonable system of state supervision in order to continue supervision in the states rather than in the Federal government.

Although the enactment of Public Law 15 of the 79th Congress did continue and may perpetuate the dominance of the states in the supervision of insurance, Congress could not abdicate its jurisdiction. Hence it may be assumed that the insurance industry still has the protection of the Supreme Court against undue burdens on insurance transacted across state lines. In the meantime, subject to review by the Supreme Court, state laws in this connection probably are valid if they are not in conflict with an act of Congress, if they do not discriminate against interstate commerce, and if they do not impair a national interest unless a state interest is deemed so important as to outweigh the impairment of the national interest. It may be said in passing, however, that although these criteria appear entirely plausible to me, there remains in their application a real potential for future litigation.

State Supervision in the United States

Turning now to state supervision in the United States, we find that a significant development took place in 1851 when the State of New York introduced the principle of requiring deposit of securities from the companies. Boards of insurance commissioners with primarily inquisitorial powers were established as early as 1851 in New Hampshire and in 1852 in Massachusetts. By 1858 the Massachusetts commission was authorized to calculate the value of outstanding policies of companies doing business in Massachusetts, although it was not until later that companies were required to maintain reserves on the net level premium valuation method and the first compulsory nonforfeiture law was enacted.

In New York, a single superintendent in 1859 was vested with extensive licensing and inquisitorial powers. During the next ten years, thirty-five other states undertook supervision either by delegating the responsibility to officials already in office or by the establishment of special departments.

During the next forty or more years there was developed at the state level rather complete legislation and administrative routines, naturally to a varying extent in different states. Conspicuous among the new developments was the recognition of the preliminary term valuation system, or modifications thereof, in the measurement of financial condition.

Probably the most significant and certainly the most widely publicized development in the field of state supervision was the legislation in New York following the 1905 investigation of the life insurance business by a committee under the chairmanship of Senator Armstrong. Because of practices in some companies revealed by the investigation, the New York Legislature established, as to business done in all states by companies licensed to do business in New York, controls on agency compensation, total sales and field costs, and total expenses of operation, as well as a limitation on the amount of new business permitted to be done in any one year. Moreover, it was decreed that such companies must declare dividends annually instead of on the tontine basis. All of this legislation was designed to effectuate a control on expenses. No financial unsoundness in any company was revealed by the investigation. However, no officer or director of a company licensed in New York was thereafter permitted to have a personal financial interest in any of its investment operations.

No outline of important developments in state legislation would be complete without mention of the so-called Guertin laws generally enacted during the 1940's. It had been increasingly urged in the 1930's that the mortality tables permitted for valuation of liabilities were completely out of date. Upon the recommendation of a special technical committee under the chairmanship of Alfred Guertin, then Actuary of the New Jersey Insurance Department, the National Association of Insurance Commissioners joined with the companies in support of uniform valuation and nonforfeiture legislation. This legislation incorporated more modern tables for valuation purposes and provided for modified preliminary term valuation by a system called the Commissioners' Method. Of special interest was the introduction of a new concept in United States nonforfeiture legislation. Although, traditionally, nonforfeiture values had up to that time been related to and derived from the reserves, the Guertin legislation prescribed a minimum standard of nonforfeiture values independent in definition and derivation from the reserves.

A further development of significance in state supervisory activity followed the enactment by the 79th Congress of Public Law 15 when the commissioners' association and an all-industry committee cooperated in developing and urging enactments to strengthen state insurance regulatory laws. Some of the resulting enactments constituted affirmative state legislation for rate regulation in the fire and casualty fields, while others expanded and strengthened areas of regulation in many states.

Comparison—Canadian and United States Supervision

With this broad outline of the legislative history of insurance supervision in both Canada and the United States before us, let us now turn to several points which warrant comparison. Whereas in Canada the examination of the financial condition of foreign companies and of companies doing business in more than one province is the responsibility of the Dominion Superintendent, the National Association of Insurance Commissioners of the United States has devised a joint examination system, the country being divided into six zones. Under this system, the home state examining force is joined by a representative from each of the other zones in which the company being examined operates and the so-called Zone or Convention examinations, which are intended to be triennial, may last as long as six or more months. This system would seem to be entirely adequate and a reasonable working method as between the states. In addition, the National Association has established a permanent central bureau charged with the responsibility of valuing securities held by the insurance companies. These procedures combined with comparatively uniform and quite rigid standards for the valuation of liabilities may be regarded as the counterpart of the corresponding Dominion activity in Canada.

Comparison—State with Provincial Supervision

When we compare state with provincial legislation and regulation, we find that on the more intimate supervision of the day-to-day operations of the United States insurance companies, legislation and regulation both are much more intricate than in Canada, and permit in many instances much less discretion. In Canada, there is a high degree of uniformity. In the United States, there is a measure of uniformity, some instances being noteworthy, yet much diversity remains. In each country there is one outstanding example of marked lack of uniformity. In Canada, legislation in the Province of Quebec does not follow the Uniform Insurance Act. However, these nonconforming Quebec laws are applicable only to business transacted within the province. In the United States, as has been recently pointed out by B. M. Anderson before the Insurance Section of the American Bar Association, New York State has enacted such legislation and promulgated such regulations over a long period of time as to result in nation-wide supervision through the medium of one state insurance department. This is brought about by a peculiar statute requiring as qualification for license that an out-of-state company conform with the requirements of New York State not only in New York but in all of the states in which it is doing business. Although New York is not the only state which has embarked upon extraterritorial supervision, it is the most conspicuous, not only from the standpoint of the proportion of the business affected, but also in respect to the number of phases involved.

Mr. Anderson has pointed out that the impact of the New York laws affects a large proportion of United States business since the majority of such business is done by companies licensed to do business in New York. However, the impact probably is more general. After having talked with executives of a number of companies not licensed in New York, I am sure, for example, that their agents' contracts respond competitively to changes in such contracts of companies licensed in New York. Moreover, I suspect a rather good case could be made even for the view that this New York legislation has some effect upon Canadian operations through Canadian competition with United States companies licensed in New York doing business in Canada.

Prominent among the New York sections having to do with extraterritorial supervision are the following: Section 42, which forbids the transaction of any type of business in another state which the company is not licensed to do in New York, except that by recent amendment casualty and surety companies and fire and marine companies are permitted to write any kind of insurance other than life insurance, annuities, title insurance, and insurance on the life of property; Section 90, which requires that all investments of an out-of-state company comply in substance with such limitations as apply to domestic companies; Section 204, which provides for minimum initial group life insurance premiums in all states and the filing of commissions, compensation or other allowances applicable in all states; Section 212, which places a limit on the amount of new business which can be done in all states; Section 213, which establishes a limit in all states upon the first year commissions, the first year expenses, renewal commissions, agency expenses, and total expenses; Section 221, which requires a prefiling of minimum initial premium rates and a prefiling of maximum commission rates for group accident and health business; and, most recently, Section 226, which deals with uniform allocation of income and expenses.

Although I honestly must express the opinion that this type of New York legislation, born of criticisms and recommendations by the Armstrong Committee fifty years ago, seems to me to manifest currently a desire for increasingly detailed controls, nevertheless there is not meant any reflection on the conscientious job which has been done by a long line of supervisory personnel in administering the laws. Due to the nature of these laws and particularly in view of the required intimate scrutiny of many phases of company management, it is surprising, at least to one connected with an out-of-state company, that the New York Department has been able to maintain a position which is at the same time both searching and understanding.

Generally speaking, there is no legislation in other states which conflicts with this broad extraterritorial New York program. Any attempt by other states to enact such a program might conceivably precipitate chaos. Under such conditions, it would seem that Congress would be justified in reconsidering the question of Federal supervision.

In reviewing nation-wide excursions into Canadian as well as American fields of local supervision, it may be observed that in Canada attempts to impose a national supervisory agency over established local supervision met repeated defeats through the courts; and the situation created in the United States by the *South-Eastern Underwriters* decision, which might have resulted in an over-all supervisory agency taking over from existing local supervisory authority, also failed to have that result, in this instance because of national legislation. If one state continues to assume the role of a nation-wide supervisory authority, might we not expect this to result in challenge followed by some form of corrective action?

In any event, in the United States, the states have continued to preempt the regulatory field. Under these circumstances there has been, with few exceptions, a quite sympathetic understanding between those charged with the responsibility of administering the affairs of life insurance companies and supervisory officials. A number of well-established and well-manned insurance departments contribute sincerely and sometimes vitally to the betterment of the business. The National Association of Insurance Commissioners brings all supervisory officials together to resolve their individual and common problems. Certainly one important reason for the continuation of state supervision is the maintenance of close contact on matters involving variations born of different localities and situations. Communication with most state insurance departments is usually very informal and easy access may be had to those in ultimate authority.

Federal Supervision Probably Simpler but Less Informal

Under Federal supervision, Federal statutes almost surely would be simpler and less restrictive than the over-all combination of state legislation. Under state regulation, a company licensed to do business in all states must, as a practical matter, arrange its operations in such a way as to conform with the most severe regulation related to any phase of its operations. As an example of unusual severity, some New York statutes are so stringent as to prevent the licensing of a number of fine companies doing business in a majority of the other states. These fine companies have unquestionably sound financial structures and several provide insurance at a lower net cost than do some of the companies licensed in New York. It is difficult to imagine that any Federal statute would preclude the continued operation of such companies, or that such a statute would embody regulatory features of state laws which in effect discriminate between varying types of well-managed companies. It would be expected that any Federal legislation would be so written as to require companies to be strong financially and to conduct their affairs in such a way as to provide adequate service at reasonable cost. Congress would certainly not attempt to perpetuate variations in statutory requirements on a geographical basis. However, it may be assumed that channels of communication with regulatory authority would be far less informal and that consideration of variations of locality and situation would be far less feasible. Federal supervision of whatsoever nature has a singleness of view which because of the gigantic proportions of the enterprise becomes peculiarly insulated from private opinion and frequently from public opinion.

Up to this point we have reviewed some high points of the legislative history of insurance supervision in Canada and the United States, have compared to some extent the supervisory agencies of the two countries as they operate today, and have made some general comments on State in contrast to Federal supervision. There remain the questions of what principles should be incorporated in any attempts to improve the present setup and how such improvements might be brought about.

Possible Improvements

First let us look at possible improvements. Although it would seem that in Canada the established interrelationships leave little to be desired, instances in the United States of extreme divergence from uniformity and the growing tendency toward more detailed regulation might well be remedied.

In approaching the question of the adequacy of state laws, numerous suggestions have been made. Among them, the following three specific items seem to me particularly worthy of attention in states where they are not already in effect:

1. The commissioner should have more discretionary power in certain instances than he currently has. All too frequently our statutes in regard

to such things as policy provisions and the like are quite inflexible, permitting no discretion on the part of the commissioner in his supervisory conduct. Fundamentally, I suppose he should have discretion at least to approve a clause or action which he considers more favorable to policyholders than that which is called for by his own statute. The introduction of such discretionary power, of course, assumes the appointment and continuance in service of highly competent and fair-minded career supervisory officials; otherwise, it might in some instances open the door to arbitrary action.

2. It would seem that regulations of broad legal significance should not be made except after notice and hearing, in order that the industry and the public should each have an opportunity to express its opinion on the impact of the regulations. Even though such an approach usually is followed, it should be clearly required.
3. The commissioner should be required to make "findings of fact" in connection with any new regulation. When a commissioner lays down a regulation establishing a general rule for the future, it takes on the character of subordinate legislation. The required "findings of fact" would of course be a fine check within the insurance department itself, would place his action under the scrutiny of the public and, incidentally, would establish a basis for judicial review in case his ruling were to be challenged. Such an orderly procedure would seem to be quite in keeping with the dignity and character of the commissioner's position.

Means of Achieving Improvement

As to what can be done to bring about major improvement, there are several possibilities. I suppose under normal circumstances we must look to a greater understanding between the insurance supervisory officials and the insurance business to bring about improvement although, fundamentally, responsibility rests with the insured public. Their desires and demands certainly are reflected or should be reflected in the state legislatures.

A possible means of achieving improvement as to some matters is court action. Occasionally in both Canada and the United States recourse is had to litigation in the hope of correcting an unduly burdensome statute or regulation or of defeating on constitutional grounds a statute deemed unjust. Current points of possible litigation have been pointed out by B. M. Anderson before the Insurance Section of the American Bar Association at its recent meeting. He has questioned the constitutionality of the application of the New York limitation of expense and some other New York laws to nondomestic companies as to their business in all states. He has also questioned state premium taxation at rates in excess of the average rate. However, I believe it is only under the most extreme circumstances that resort should be had to the courts.

Still another possibility is the enactment of retaliatory laws. On a number of occasions I have heard such laws mentioned as a possible means of influencing a particular state to withdraw from what is considered to be an improper invasion of the sovereign rights of a sister state. Unquestionably any appreciable number of retaliatory laws, or even such a prospect, would ultimately bring about salutary results, although in the process innocent bystanders would be hurt. Also, if the retaliation became extensive enough, the confusion generated might be expected to result in the substitution of Federal supervision of insurance transacted across state lines.

Conclusion

In conclusion, it might well be asked if the simplicity and uniformity in Canadian supervision gives us any clue as to whether we in the United States, as individuals, as actuaries, and as insurance executives, have lacked understanding of the working tools of the democratic process. This is not a suggestion that we actuaries try to become politicians; it is nevertheless a reminder that there always is a political side to legislative action, even though we may in our logic as actuaries consider a particular question settled beyond debate. Supervisory legislation and regulation are matters for compromise, and it is to be hoped that through improved understanding, and by the continued and effective use of the democratic process, we in the United States may continuously move toward a better system, a more uniform system, a system which could not be construed as restraining interstate commerce. Achievements of recent years such as the Guertin laws and the various types of uniform legislation which followed Public Law 15 demonstrate what can be accomplished in the direction of soundness and uniformity when state insurance departments and the insurance business recognize a need for change.