Congressional Research Service
Informing the legislative debate since 1914

IN FOCUS

January 15, 2015

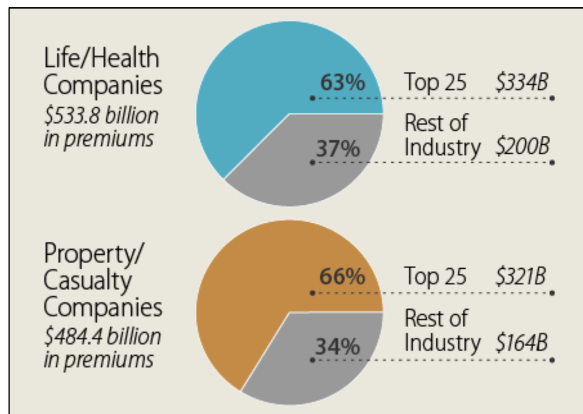
Introduction to Financial Services: Insurance Regulation

This *In Focus* provides a summary of the insurance regulatory system in the United States.

Market Structure

Insurance companies constitute a major segment of the U.S. financial services industry. The insurance industry is often separated into two parts: *life and health insurance* (life/health), which also includes annuity products, and *property and casualty insurance* (property/casualty), which includes most other lines of insurance, such as homeowners insurance, automobile insurance, and various commercial lines of insurance purchased by businesses. According the insurance rating agency AM Best, 2013 premiums for the nearly 900 life/health companies in the United States totaled $533.8 billion, with assets totaling $6.08 billion. Premiums for 2013 p for the nearly 3,000 property/casualty insurance companies totaled $484.4 billion, with assets totaling $1.76 trillion. Despite the large numbers of insurance companies, both life/health and property/casualty insurance are also reasonably concentrated industries, with the top 25 life/health companies writing 63% of overall premiums and the top 25 property/casualty companies writing 66% of overall premiums. **Figure 1** displays the market share of the top 25 insurers versus the rest of the market.

Figure 1. Market Concentration



Source: CRS using date from AM Best.

Different lines of insurance present very different characteristics and risks. Life insurance typically is a longer-term proposition with contracts stretching over decades and insurance risks that are relatively well defined in actuarial tables. Annuity products, which are also usually offered by life insurers, present similar long-term insurance risks. Particular life insurance and annuity products, however, may be based on securities like stocks or bonds, and thus may present shorter-term risks more similar to investment products for both the consumer and the insurer.

Property/casualty insurance typically is a shorter-term proposition with six-month or one-year contracts and greater exposure to catastrophic risks.

Health insurance has evolved in a very different direction than life and property/casualty insurance. Many health insurance companies are heavily involved with healthcare delivery, including negotiating contracts with physicians and hospitals, rather than purely insurance operations. The health insurance regulatory system is much more influenced by the federal government through the Medicare, Medicaid, the Employee Retirement Income Security Act of 1974 (ERISA; P.L. 93-406), and the Patient Protection and Affordable Care Act (ACA; P.L. 111-148). The following discussion concentrates primarily on property/casualty and life insurance.

Role of Federal and State Governments

The role of the federal government in regulating private insurance is relatively limited compared with its role in banking and securities. Insurance companies, unlike banks and securities firms, have been chartered and regulated solely by the states for the past 150 years. There are no federal regulators of insurance akin to those for securities or banks, such as the Securities and Exchange Commission (SEC) or the Office of the Comptroller of the Currency (OCC), respectively.

Each state government has a department or other entity charged with licensing and regulating insurance companies and those individuals and companies selling insurance products. States regulate the solvency of the companies and the content of insurance products as well as the market conduct of companies. Although each state sets its own laws and regulations for insurance, the National Association of Insurance Commissioners (NAIC) acts as a coordinating body that sets national standards through model laws and regulations. Models adopted by the NAIC, however, must be enacted by the states before having legal effect. The states have also developed a coordinated system of guaranty funds, designed to protect policyholders in the event of insurer insolvency.

The limited federal role stems from both Supreme Court decisions and congressional action. In the 1868 case *Paul v. Virginia*, the court found that insurance was not considered interstate commerce, and thus not subject to federal regulation. This decision was effectively reversed in the 1944 decision *U.S. v. South-Eastern Underwriters Association.* In 1945, Congress passed the *McCarran-Ferguson Act* (15 U.S.C. §1011 et seq.) specifically preserving the states' authority to regulate and tax insurance and also granting a federal antitrust exemption to the insurance industry for "the business of insurance."

The Dodd-Frank Act (P.L. 111-203) in 2010 significantly altered the overall financial regulatory structure in the United States, but it largely left the state-centered insurance regulatory structure intact. The areas where the act did affect insurance regulation include (1) enhanced systemic risk regulatory authority, including authority over insurers, was vested in the Federal Reserve and in the Financial Services Oversight Council (FSOC), a new council of regulators headed by the Treasury Secretary; (2) oversight of bank and thrift holding companies, including companies with insurance subsidiaries, was consolidated in the Federal Reserve with new capital requirements added; and (3) the creation of a new Federal Insurance Office (FIO) within the Treasury Department. The Dodd-Frank Act also included measures affecting the states' oversight of surplus lines insurance and reinsurance.

Policy Issues

Recent congressional attention to insurance regulatory issues can be broken into three broad areas:

Dodd-Frank Act Implementation. Among these issues are

1. The application of new holding company *capital standards* to insurers, particularly Section 171 (known popularly as the Collins Amendment). Banking and insurance present different risk profiles and it is generally accepted that they require different capital standards. Under the Collins Amendment, the Federal Reserve indicated it believed it did not have the ability to suitably tailor capital rules for insurers and would need a legislative change in order to do so. The 113th Congress passed S. 2270 (P.L. 113-279) to address these concerns.
2. The treatment of insurers under Dodd-Frank's *systemic risk* regime. Under Dodd-Frank, insurers have been designated as systemically important and insurers with assets of more than $50 billion could be assessed for future costs of the new resolution regime. Both the systemic designation of insurers and the insurer's role in resolution has been criticized, with legislative proposals to address both issues.
3. The role of the *Federal Insurance Office* and the *Federal Reserve*. Dodd-Frank gave the FIO a number of roles both domestically and internationally. Exactly how the mandates are applied and how the FIO interacts with existing actors like the NAIC, the International Association of Insurance Supervisors (IAIS), and the United States Trade Representative (USTR), however, are not clear from the statute. Dodd-Frank also resulted in the Federal Reserve taking role overseeing many more insurers than it had in the past. Some frictions have been reported, particularly between state regulators and the new federal actors in the international arena. To date, neither the FIO nor the Federal Reserve have used significant portions of their authority, such as FIO's preemption authority related to international covered agreements or the actual application of Federal Reserve capital standards to some insurers.

Targeted Federal Legislation Changing the State Regulatory System. The 50-state system of insurance regulation has been particular criticized on efficiency grounds due to perceived duplicative and burdensome regulation. This resulted in proposals ranging from a full federal chartering system for insurers to narrower targeted efforts to simplify the state system. Legislation from recent Congresses has included (1) creation of a National Association of Registered Agents and Brokers (NARAB) to reduce the need for multiple licensures of insurance agents and (2) expansion of the federal Liability Risk Retention Act, which preempts state insurance company licensure laws for a small subset of insurance companies. The 114th Congress included NARAB provisions in Title II of H.R. 26, which was enacted as P.L. 114-1 on January 12, 2014.

Response to International Developments. The European Union (EU) and the International Association of Insurance Supervisors (IAIS) are undertaking separate initiatives that have provoked concern in the United States. The EU's Solvency II regulatory modernization program includes a reciprocity designation, which could disadvantage U.S. insurers if the United States is not judged a reciprocal jurisdiction. The IAIS, following a charge from the Financial Stability Board, is developing new capital standards for insurers on a relatively tight timeframe, with final standards planned to be in place by 2018.

CRS Resources

CRS Report R43067, *Insurance Regulation: Issues, Background, and Legislation in the 113th Congress*, by Baird Webel.

CRS Report R41372, *The Dodd-Frank Wall Street Reform and Consumer Protection Act: Insurance Provisions*, by Baird Webel.

CRS Report RL32237, *Health Insurance: A Primer*, by Bernadette Fernandez and Namrata K. Uberoi.

Baird Webel, bwebel@crs.loc.gov, 7-0652

IF10043