Chapter Four

Options for Reducing the Risks of a Solvency Crisis in the Insurance Industry

Although the risks of a solvency crisis in the insurance industry can never be eliminated, appropriate policies can significantly reduce those risks. An important policy for reducing the magnitude of a possible solvency crisis is to regulate solvency effectively.

In recent years, analysts have criticized many aspects of the solvency regulation of the insurance industry, which is done entirely at the state level. The states are working to strengthen their solvency regulations, but some analysts believe that the states will never fill all of the gaps and create a uniform system of minimum standards for effective solvency regulation nationwide. Consequently, some policymakers have proposed a larger role for the federal government in regulating the solvency of insurers.

Even a sound insurance industry, however, may be unable to cover catastrophic increases in claims arising from natural disasters and other sources (see Chapter 2). Property and casualty insurers do not hold sufficient reserves to cover truly catastrophic amounts of claims, and such claims would account for a significant fraction of the capital and surplus of the industry. Policymakers have therefore considered options to help strengthen the ability of the industry to cover the losses from natural catastrophes, and these options also affect the chances of a solvency crisis.

Finally, the run on the Mutual Benefit Life Insurance Company in 1991 clearly showed that life insurers are exposed to the risk of runs by policyholders. Runs by nervous policyholders could force insurers to suffer losses from selling illiquid assets on short notice and create solvency problems for some insurers. As a result, policymakers are considering options designed to expand the liquidity of the life insurance industry and reduce the chances of destructive runs.

Options for Improving Solvency Regulation and Strengthening the Guaranty Funds

Options run the gamut from letting the states continue their efforts to strengthen their system to creating a new federal agency to supervise and regulate the insurance industry. The federal options exist because some analysts doubt that the states will ultimately succeed in strengthening their systems. The doubts are not so much about whether the states can devise strong solvency regulations but whether all of the states will put in place and enforce a uniform system of effective minimum standards for solvency regulation nationwide. Such a system would limit the possibility that insurers, and even individual states, could take advantage of the current system of solvency regulation. The proposed federal roles could remove doubts about the uniformity of minimum standards nationwide, but they would not eliminate the possibility that the states could force the federal government to pay for the costs of a future solvency crisis.

The State System of Solvency Regulation and Guaranty Funds

The option of letting the states strengthen the existing system continues the history of state regulation of insurance companies. The first insurance companies were located and wrote policies in a single state and were subject to the regulations of that state. Later, as the nation and the insurance industry grew, state responsibility for regulating the solvency of insurance companies rested on an 1869 ruling by the Supreme Court that an insurance contract was not an instrument of commerce and, consequently, not interstate commerce subject to federal regulation, including federal antitrust law. The Supreme Court overturned this position in 1944, but in the McCarran-Ferguson Act of 1945, the Congress gave the states continued authority to be the primary regulators of the insurance industry.[1]

This act also granted the insurance industry a qualified exemption from federal antitrust scrutiny.[2] One rationale for this exemption is that it allows insurers to use standardized insurance contracts and to pool their information on losses to establish actuarially sound insurance premiums and reserve levels. Such information is especially important for property and casualty insurers covering risks that are difficult to underwrite, such as general liabilities. Critics charge that the exemption allows insurers to collude and set above-market premium rates, but this view is not widely shared.

Regulation. Each state, the District of Columbia, and Puerto Rico, American Samoa, Guam, and the Virgin Islands has its own insurance department, run by an elected or appointed commissioner, to enforce its own set of laws and regulations governing all aspects of its insurance market. These laws and regulations cover licensing insurance companies, setting premium rates, establishing standards for safe and sound business practices, examining insurers, determining actions that regulators can use to deal with financially impaired insurance companies, and operating the state guaranty funds. They also address complaints by consumers about other aspects of the operations of insurers, such as how quickly loss claims are paid. Partly because of the different circumstances in each state, such as the number and size of insurers licensed there, states employ different amounts of resources in their insurance departments.

Although the state insurance departments are independent of each other, they have worked out several voluntary, cooperative arrangements to exploit the overlap of their responsibilities. One arrangement concerns examining insurers.

Theoretically, an insurer licensed to operate in more than one state (a multistate insurer) is subject to the solvency regulations of every such state, meaning that each state would need to examine the insurer regularly. Because multiple examinations would be a burden on insurers and an unnecessary duplication of effort by state regulators, the state in which the insurer is legally chartered or domiciled (the home state) takes the lead in examining the insurer. Consequently, a multistate insurer effectively may be subject only to the solvency regulations of its home state, though it will face different regulations on other aspects of its business practices, such as premium rates.[3]

1. See David Whiteman, "Insurance Industry Regulation and Supervision: A Reexamination of the McCarran-Ferguson Act of 1945," 1B-86149 (Congressional Research Service, August 25, 1988), p. 1.

2. Stock-chartered insurance companies are subject to oversight by federal authorities, such as the Securities and Exchange Commission, that are responsible for monitoring corporate behavior.

3. General Accounting Office, *Insurance Regulation Problems in the State Monitoring of Property/Casualty Insurer Solvency*, GAO/GGD-89-129 (September 1989), p. 23.

Another arrangement is the National Association of Insurance Commissioners (NAIC), which includes the insurance commissioners of the 50 states, the District of Columbia, Puerto Rico, American Samoa, Guam, and the Virgin Islands. The NAIC supports state efforts by maintaining a central data base containing financial data and other relevant information on insurance companies and by analyzing the financial statements of insurers. The NAIC also recommends procedures for examining insurers and valuing assets, among others, and model laws and regulations for use by the states. The NAIC, however, has no authority to compel the states to adopt its recommendations, which critics view as a compelling argument in favor of a greater federal role in regulating the solvency of insurers.

Guaranty Funds. Guaranty funds attempt to limit the losses that policyholders may suffer when their insurer fails. In doing so, the funds also limit the potential for runs by policyholders. The funds were first started in the late 1960s in response to a rash of insolvencies of automobile insurers. Since then, every state and the District of Columbia has created funds covering various lines of property and casualty insurance as well as certain life and health insurance policies and products sold in its jurisdiction.

With the exception of New York, states collect monies to finance their guaranty funds only after an insolvency occurs; as discussed later, this method does not limit the potential for insurers to take advantage of the system. When an insurer that writes lines of business covered by the guaranty fund becomes insolvent, the fund estimates how much it will cost to cover the insolvent insurer's obligations to policyholders in that state. The fund then collects the necessary monies by assessing the remaining solvent companies (chartered in the United States and abroad) that are licensed in the state and write the same lines of business. Total assessments paid by an insurer in a given year to cover the costs of all relevant insolvencies in the state are capped at 2 percent of the insurer's annual premiums in most states. If the assessments are insufficient to cover the insolvent insurers' obligations to policyholders, the solvent insurers may be assessed in successive years. The NAIC's model law on guaranty funds allows a fund to borrow against future assessments, although it is difficult to know how easily funds could do so in the event of a solvency crisis.

Guaranty funds do not cover all policyholder losses in full, however. They do not cover all lines of business, and the amount of protection varies by state. Many states exclude certain types of property and casualty insurance such as financial guaranty and ocean marine insurance. Some life and health guaranty funds do not cover all types of annuities and guaranteed investment contracts. Guaranty funds cover only policyholders of licensed insurers; members of risk-retention groups and policyholders of surplus lines and other unlicensed insurers are not covered and would need to seek repayment by other means. Some state guaranty funds only cover policyholders who are residents of their state, as specified in the model laws of the NAIC, and other funds cover all policyholders of an insolvent insurer domiciled in the state.

Property and casualty guaranty funds in most states and the District of Columbia place the maximum protection for policyholders at the lesser of $300,000 or the amount of the insurance policy limit; except for California, the remaining states (including Puerto Rico) have lower maximums. A few states do not cover property and casualty claims of policyholders whose net worth exceeds a certain limit, generally $50 million. Most states, Puerto Rico, and the District of Columbia have deductibles for claims of losses filed on policies of insolvent property and casualty insurers. Most deductibles are $100, but they range between $10 and $200. Unearned premium payments on property and casualty policies are covered by almost every state, but a cap or deductible limits the amount covered in some states.

Life and health guaranty funds in most states cover direct life policies to a limit of $300,000 in death benefits, $100,000 in cash surrender value for life insurance, $100,000 in present value of annuity benefits, and $100,000 in health benefits. Many life and health guaranty funds limit the total benefits payable to $300,000 per policyholder. Less than half of the states cover unallocated annuity contracts, which are a type of guaranteed investment contract; their maximum coverage is usually only $5 million on any one contract, which could effectively be owned by many beneficiaries. Unearned premiums on life and health policies are not returned to policyholders because the guaranty funds continue coverage for the full policy period, either directly or by transferring the policy to another insurer or administrator. In the event of a solvency crisis, however, policyholders could lose some or all of their unearned premiums.

Although the solvent insurers pay assessments to their guaranty fund, they do not take all of the assessments out of their profits. Insurers can pass the cost of the assessments onto state taxpayers through a credit on their premium taxes or to policyholders through higher premiums, depending on state law. Even federal taxpayers pay a small portion.

Efforts by the States to Improve Solvency Regulation and Guaranty Funds

The option of letting the states strengthen their system relies on the efforts of the NAIC to create a stronger and uniform system of minimum standards. The NAIC's Financial Regulation Standards (FRS) is supposed to supply the strengthening, which the NAIC defines as the minimum standards for effective solvency regulation at the state level. The uniformity is supposed to come from the NAIC's accreditation program, which is designed to elicit the voluntary adoption of the FRS by every state.

Because the NAIC lacks the authority to require all states to adopt its FRS, it has included an incentive for states to become accredited in its model law on examinations. The incentive is that accredited states may not accept examinations of insurers by nonaccredited states except in limited circumstances. Consequently, multistate insurers operating in nonaccredited states will face the added costs of multiple examinations, which, in the NAIC's view, will put pressure on their home states to become accredited.

The Accreditation Program. This program is designed to establish uniform minimum standards for solvency regulation in all states. The program consists of two parts: a thorough, on-site review of state insurance departments every five years, and interim reviews every year.

The on-site review attempts to cover all of the relevant aspects of a state's regulatory function. The review team submits a report to the NAIC's Financial Regulation Standards and Accreditation Committee, which decides whether the state meets all of the requirements for accreditation.

The interim annual reviews are conducted on the first four anniversaries of the state's accreditation. The purpose of these interim reviews is not only to ensure that states are making all improvements recommended by the on-site review teams, but also to ensure that the states continually update their laws and regulations for changes in the FRS.

Financial Regulation Standards. The NAIC considers these standards to be the minimum ones for effectively regulating the solvency of insurers. They address all of the major aspects of solvency regulation and include the NAIC's current model laws and regulations and its recommended accounting, asset valuation, and examination procedures. In particular, the standards attempt to incorporate some important lessons learned from the solvency crisis in the savings and loan industry, including the importance of strong, risk-based capital requirements and early actions to correct problems of financially impaired companies.[4] The standards are classified into three groups:

- o Laws and regulations that states must have to define safe and sound business practices and reporting requirements for insurers and to establish the authority of the state insurance department to examine insurers;

- o Regulatory practices and procedures for financial analyses and examinations of insurers and for dealing with financially impaired insurers; and

- o Necessary organizational and personnel practices for an efficient and professional insurance department.

Although the FRS addresses all of the major areas necessary for effective solvency regulation, early forms of some standards have been criticized as too general to be useful in establishing a uniform system of effective nationwide solvency regulation. Of course, it is impossible to set specific or rigid requirements or conditions for all possible contingencies. Moreover, the lack of specificity in some cases may reflect a tension between a desire by the states for flexibility in setting their own regulations and the need to set up specific standards. But more specific guidelines are possible in some important areas.

One area in which the NAIC has provided more specificity is capital requirements for insurers. The NAIC adopted in December 1992 new, risk-based capital requirements for life and health insurers; those requirements include specific trigger points for early regulatory actions when capital levels fall below the required levels.

The requirements gear the amount of capital that an insurer must hold to the size of the various risks assumed by the insurer. These risks include not only those inherent in the insurer's assets, similar to the risk-based capital requirements for banks and thrift institutions, but also the insurance, interest rate, and business risks assumed by the insurer. These new requirements and trigger points may not be effective until the end of 1995, however, because the NAIC allows the states two years to adopt new model laws added to the FRS. In 1993, the NAIC proposed specific, risk-based capital requirements for property and casualty insurers, which are similar in spirit to those for life and health insurers. Those requirements may not be in place for several years.

Progress of the Accreditation Program. The accreditation program has had some early problems. The General Accounting Office found that the program suffered from inadequate documentation, procedural requirements, and attention to how well state regulators are implementing their existing regulatory authority and required practices.[6] These may have been only temporary start-up problems for the program that were or are being corrected, but GAO continued to criticize the program in a follow-up analysis.[7]

Moreover, the NAIC has not yet accredited all 50 states. By early December 1993, only 32 states had accreditation, with a number of important states, such as Connecticut and New York, still not accredited.

Nevertheless, apart from formal accreditation, the states have worked hard to improve

---

4. These and other lessons of the solvency crisis in the savings and loan industry are discussed in Lawrence J. White, *The S&L Debacle* (New York: Oxford University Press, 1991).

5. Charles Schmidt, "Regulators Adopt RBC Standards for Life/Health Insurers," in A.M. Best Company, Inc., *Best's Review: Life/Health Insurance Edition* (Oldwick, N.J.: A.M. Best Company, Inc., January 1993), pp. 105-107.

6. General Accounting Office, *Insurance Regulation: Assessment of the National Association of Insurance Commissioners*, GAO/T-GGD-91-37 (May 22, 1991); and General Accounting Office, *Insurance Regulation: The Financial Regulation Standards and Accreditation Program of the National Association of Insurance Commissioners*, GAO/T-GGD-92-27 (April 9, 1992.)

7. General Accounting Office, *Insurance Regulation: The National Association of Insurance Commissioners' Accreditation Program Continues to Exhibit Fundamental Problems*, GAO/T-GGD-93-26 (June 9, 1993).

their efforts at solvency regulation. For example, the NAIC noted that 42 states adopted changes consistent with its FRS in 1991.[8] In 1992, 40 states and the District of Columbia adopted changes consistent with the FRS; the average number of changes for those states was five. Without a formal review, however, it is difficult to know how effective and useful these changes may be.

Concerns About the Current State System for Solvency Regulation

By accident or design, the state system for regulating the solvency of insurers has worked fairly well until recently. The number and cost of insolvencies have been relatively low for many years, especially when compared with the solvency crisis in the savings and loan industry, and have required little attention by federal policymakers. Strains in the system have appeared more recently, however. Although analysts debate the role played by the state system in intensifying these strains, concerns remain about the lack of uniform minimum standards for solvency regulations among states; the ability of the states to manage a solvency crisis; the ability of the states to regulate insurers chartered abroad (alien insurers); moral hazard in, and unequal coverage by, the state guaranty funds; and the extra costs of regulation imposed by multiple state jurisdictions.

Lack of Uniform Minimum Standards for Effective Solvency Regulation. A major concern is the ability of the states to establish and enforce a uniform system of minimum standards for effective solvency regulation. Certainly, the states have the power to do so. For example, in another context, every state except Louisiana has adopted the Uniform Commercial Code, and Louisiana's code is close enough that it has not hindered commerce with other states.

However, the incentives for the states to adopt uniform minimum standards for effective solvency regulation may not be very strong because an uneven state system contains two and possibly three important weaknesses. One is that insurers might be able to take advantage of, or "game," a system of uneven standards. As noted earlier, multistate insurers are effectively subject to the solvency regulations of their home states. If the minimum standards for solvency regulations vary among states, different insurers will be subject to solvency regulations of varying effectiveness. This diversity gives insurance companies an opportunity to avoid strong solvency regulations by locating their headquarters in states with weak regulations.

This problem would not arise if the costs and benefits of a state's solvency regulations remained solely within the state. In that case, the state would pay all of the costs of its weak solvency regulation. The problem exists because other states share the costs and benefits, chiefly through the workings of their guaranty funds. A state benefits from strong solvency regulations used by other states, and it may be forced to bear some of the costs of the insolvencies arising from weak solvency regulations used by others. This sharing of the costs and benefits creates a second weakness--individual states might also be able to game the system. The states may have an incentive to save on the administrative, enforcement, and other costs of solvency regulation by employing weak standards because other states pay some of the costs of reimbursing policyholders of insolvent insurers through the state guaranty fund system.

Some analysts worry that a third flaw is inherent in any state system of solvency regulation--the states together might be able to game the system against the federal government. The federal government has no explicit contingent liability to cover the costs of a possible solvency crisis in the insurance industry. However, some analysts believe that

8. Testimony of the National Association of Insurance Commissioners before the Subcommittee on Oversight and Investigations of the House Committee on Energy and Commerce, April 9, 1992, p. 9.

the federal government already has an implicit contingent liability to cover the costs because it has covered some of the costs of other large catastrophes in the past. Knowing that the federal government may respond to a solvency crisis, all of the states have an incentive to skimp on their efforts to regulate solvency.

Although these weaknesses exist in theory, their practical importance is difficult to ascertain. It is not clear that many, even any, insurers or states currently game the system in these ways; determining this probably would require a significant amount of research. Blunting these incentives are those for state regulators to maintain strong solvency regulations to avoid the political fallout arising from a spate of insolvencies whose costs were passed on to state policyholders and taxpayers. Nor is it clear that the federal government already has an implicit contingent liability to cover the costs of a solvency crisis in the insurance industry.

The NAIC also believes that peer pressure among state regulators, political support from multistate insurers, and incentives--such as the one already used by the NAIC--will be sufficient to compel every state to adopt and maintain uniform minimum standards. Indeed, with considerable attention focused on this issue, the states are working to bring their solvency regulations in accord with the NAIC's Financial Regulation Standards.

It is worth noting, however, that several oft-cited benefits of the state system are incapable of compensating for the lack of uniform minimum standards for effectively regulating solvency. The diversity of the state system can be viewed as a strength because the system can be diversified with 50 different regulators, which reduces the odds of a massive regulatory failure. Moreover, the states may be more likely to maintain a strong system of solvency regulation because they have introduced innovations in other areas of state concern, such as welfare reform. Insurers also may choose to locate in a state that has strong solvency regulations to gain an advantage in marketing their products. However great these benefits may be, they do not eliminate the potential problems created when the states use different minimum standards for regulating insurers.

Ability to Manage a Solvency Crisis. Another major concern is whether the state system can handle a solvency crisis involving a large number of insurers. The states have been straining to handle the large number of insolvencies of insurers in recent years, and the capacity of some guaranty funds has been equally strained. Numerous insolvencies in a crisis could overwhelm the states and cause long delays in resolving insurers and making payments to policyholders. In such circumstances, regulators may resort to forbearance to manage the caseload, as they did in the savings and loan crisis.

Forbearance is the policy of allowing financially impaired companies to remain in business without appropriate restrictions on risk taking in the hope that the companies will solve their financial problems. The policy is risky because it gives financially impaired companies an incentive to adopt a risky business plan that promises large gains. Because many of these risky business plans fail, however, forbearance simply raises the costs of the subsequent insolvencies. For example, the Congressional Budget Office has estimated that forbearance by the regulators of the savings and loan industry raised the taxpayers' cost of cleaning up the savings and loan crisis by $66 billion in 1990 dollars.[9]

Apart from simple delays in covering the losses of policyholders, some analysts have been concerned that the state guaranty funds do not have sufficient capacity to cover the costs of continued large numbers of insolvencies. Because the funds, except for New York's, do not hold reserves that can be drawn down in the event of an insolvency, the assessments resulting from the insolvency of a large insurer or from the insolvencies of many

9. Congressional Budget Office, "The Cost of Forbearance During the Thrift Crisis," CBO Staff Memorandum (June 1991).

smaller insurers could exceed the amount the remaining solvent insurers could be expected to pay over a reasonable period of time.

That possibility is particularly relevant in the case of a massive natural catastrophe, but also is relevant for the recent solvency problems in the life and health industry. For example, the National Organization of Life and Health Insurance Guaranty Associations estimated that the annual capacity of all life and health guaranty funds in 1992 was about $3 billion.[10] Yet, as noted in Chapter 1, the assessments for Executive Life alone are expected to total $2.1 billion. The simultaneous insolvency of several large life insurers would put a severe strain on the guaranty funds.

Some guaranty funds for the policyholders of property and casualty insurers have also faced some strains. In 1990, for example, 12 states were using at least 25 percent of the capacity of their property and casualty funds, seven states more than 50 percent, and two states 100 percent. The system has also faced large funding requirements for past insolvencies. The National Conference of Insurance Guaranty Funds estimated in 1991 that additional assessments needed for all past insolvencies of property and casualty insurers through 1989 amounted to more than $500 million.[11] This amount compares with total net assessments by all property and casualty guaranty funds in 1990 of about $450 million, and an estimated capacity for the system as a whole of about $2.8 billion using premium data for 1990.

Problems Regulating Alien Insurers. Another concern is whether the existing state system can effectively regulate insurers chartered abroad--known in the industry as alien insurers and reinsurers. The failure of an alien reinsurer could have severe consequences for U.S. insurers and policyholders because alien reinsurers write a significant amount of business in the United States. Although the states license branches and subsidiaries of alien insurers and reinsurers to write business in their jurisdictions, their ability to monitor them effectively is limited.

Whether alien insurers and reinsurers present a large risk of a solvency crisis in the United States is not clear, but alien insurers have caused losses for policyholders in the market for surplus lines in some states. This market handles lines of insurance that licensed insurers do not handle and hence is very small relative to the whole insurance market. Surplus-lines insurers must be licensed in their home state, but are not licensed to write surplus lines in other states. Although they must meet some minimum standards that vary by state, these standards have proved inadequate in some states, most recently in California. A number of policyholders in the riot-torn areas of Los Angeles in 1992 were unable to collect their claims on alien surplus-lines insurers.[12]

Moral Hazard in the Guaranty Fund System. A serious flaw in the guaranty fund system is the pricing method used to collect funds from the solvent insurers. Assessments by the guaranty funds are collected after an insolvency occurs; they are a fixed percentage of net premiums and do not depend on the amount of insolvency risk that insurers present to the fund. Consequently, an insurer has an incentive to undertake risky business and investment strategies, especially when its capital level is low. This situation raises the chances of insolvency and additional costs to the guaranty fund system. Such incentives

10. Testimony of Jack H. Blaine, Acting President, National Organization of Life and Health Insurance Guaranty Associations, before the Subcommittee on Antitrust, Monopolies and Business Rights of the Senate Committee on the Judiciary, April 28, 1992. Testimony of the American Council of Life Insurance at this hearing noted that this estimate is low because it does not include the capacities of the newly created guaranty funds in Colorado, Louisiana, and New Jersey.

11. A.M. Best Company, Inc., *Best's Insolvency Study: Property/Casualty Insurers, 1969-1990* (Oldwick, N.J.: A. M. Best Company, Inc., June 1991), p. 14.

12. Testimony of Donald J. Greene before the Subcommittee on Commerce, Consumer Protection, and Competitiveness of the House Committee on Energy and Commerce, April 28, 1993.

contributed to the enormous costs of the savings and loan crisis.

Extra Costs of Multiple State Jurisdictions. The multiplicity of state regulatory systems raises the costs of compliance for multistate insurers. Although this issue is unrelated to the risks of a solvency crisis, it does affect the price of insurance for consumers and businesses. Some of the added costs are blunted, since the home state takes the lead for solvency regulation. But these insurers still need to comply with other regulations regarding premium rates, guaranty fund assessments, and services to policyholders, for example. Some analysts question whether the extra costs are worth the benefits that accrue from allowing the states to determine the nature of their individual insurance markets.

Unequal Coverage by the Guaranty Funds. The unequal treatment of policyholders by the states, though not a factor in the risk of a solvency crisis, is a source of concern on grounds of equity. Some observers feel that it is unfair that policyholders insured by the same insurer but living in different states may receive different fixed-dollar amounts and types of protection by the guaranty funds, particularly in the case of annuities and other investment assets such as guaranteed investment contracts. They prefer uniform amounts of protection nationwide. The NAIC counters that substantial, though not complete, uniformity exists among the states.[13]

In some respects, such uniform treatment may not necessarily be desirable or efficient. The different fixed-dollar limits give the states the flexibility to tailor guaranty fund protection to their local costs of living and property values. States with a large population of retired people may also prefer more protection for investment assets than other states. Moreover, policyholders in states with relatively low levels of protection are not necessarily being shortchanged. In return for a lower level of protection, these policyholders presumably pay lower premiums or state taxes to finance their guaranty fund, depending on how their states allow insurers to treat the costs of assessments by the guaranty fund.

Other Options for Creating a Stronger, More Uniform System of Solvency Regulation

Concerns such as these have spurred policymakers to propose other ways of strengthening the solvency regulation of insurers and the protection of policyholders. These proposals attempt to create a stronger and more uniform system of solvency regulation and uniform protection of policyholders nationwide, and some call for a larger role for the federal government in the solvency regulation of insurers by amending or repealing the McCarran-Ferguson Act. Although some of these proposals overcome one or more of the moral hazards mentioned earlier, none of the proposals eliminates the potential for the states to ignore solvency concerns when regulating insurance premiums.

Proposals for a larger federal role in solvency regulation are particularly worrisome because they could create an implicit contingent liability for the federal government to cover the costs of a solvency crisis. At this point, it is hard to predict how effective the proposed federal standards for solvency regulation would be, since the proposals do not spell all of them out in detail. In general, however, they cover the same ground as the NAIC's Financial Regulation Standards.

Establishing an Interstate Compact. An association of state legislators, the National Conference of Insurance Legislators, has proposed a compact among all of the states titled the Interstate Insurance Protection Compact. This compact is limited in scope. It would attempt to improve the process of resolving insolvent insurers and protecting policyholders

13. Testimony of William McCartney, President of the National Association of Insurance Commissioners, before the Subcommittee on Policy Research and Insurance of the House Committee on Banking, Finance and Urban Affairs, July 29, 1991.