

**Federalization murky regarding captives**

By Allen Taft

We're all chewing on the pros and cons of an optional federal charter that would allow companies to do business nationally under a license issued by a new federal agency. In our world, that is known as trading 50 monkeys for one gorilla.

There's just one catch: legislation for a full-blown federal takeover (excuse me, option) is not yet on Congress' agenda. Rep. Paul Kanjorski (D-PA) introduced the Federal Insurance Office Act of 2009 that he said could regulate specific lines of coverage such as reinsurance, bond insurance and mortgage insurance. Both supporters and detractors say that would lead over time to total federalization of insurance.

The captive industry is still waiting for some sort of broad acknowledgment of alternative risk transfer by lawmakers. None of the conversations so far have provided a clue about captives' possible migration from state to federal licensing. Most captive and ART organizations are so far staying on the sidelines of the optional federal charter debate.

Of course, Rep. Kanjorski's inclusion of reinsurance as a possible federally regulated line of coverage may provide a hint. Reinsurance is often a bone of contention in regulation of captives by domestic captive domiciles as they follow prompting by the National Association of Insurance Commissioners (NAIC) to protect their accreditation by that organization.

So the question is: would a federally chartered reinsurance company be exempted from state regulation – some would say interference – in its involvement with a state-licensed captive? So far, the crystal ball is blank on that one.

The recent history of an optional federal insurance charter began with its inclusion in the Blueprint for Financial Reform offered by President George W. Bush's treasury secretary Henry Paulson. That plan could have set insurance companies free of state regulation, but last year its consideration was smothered by the government's response to the economic meltdown.

During this session of Congress the truncated version of insurance federalization is now a Democratic initiative as proposed by Rep. Kanjorski. His House Financial Services Committee's Subcommittee on Capital Markets staged a hearing this fall to elicit views of the insurance industry and representatives of state insurance regulators.

The result was darn good theater as the NAIC learned it is not uniformly held in high esteem by some who appear to be moving toward the idea of central federal control.

"Currently the U.S. is marginalized," testified David Atkinson of RGA Reinsurance Company on behalf of the Reinsurance Association of America. The state-by-state system, he said, hampers U.S. companies' ability to compete with foreign companies.

A spokeswoman for the NAIC spoke against a federal office that would operate as a national regulator of insurers. "We have a highly coordinated system that works," she said.

Oops, wrong argument. It was rebutted by Rep. Melissa Bean (D-IL), who said the NAIC has failed to enable a cohesive system in the 140 years of the organization's history. At one point she asked the industry representatives if they were confident that the NAIC would build a consistent regulatory system anytime soon.

No aye votes were registered. A representative of the American Insurance Association said, "You have to navigate 50 different political atmospheres." Another said, "It takes up to a year sometimes to get one product approved in all 50 states."

It doesn't seem likely that the debate over federalization of insurance will end anytime soon. Even if the initial current bill is passed, additional amplifying or modifying bills could be expected to follow.

And until captive insurance (other than risk retention groups) is specifically included in any legislation, captives may do well to maintain cordial relations with their host domicile's regulatory bureaucracy.

Risk retention groups, of course, operate under a quasi-federal scheme where they are exempted from interference by regulators from states other than their licensing domicile. That structure works well in some cases and less well in others. Some states actively bar elsewhere-licensed RRGs from operations when they don't agree with the

scope of their coverage. Taking state regulators out of the ART equation would certainly bring clarity to national coverage plans.

But there would still be that 900-pound gorilla of a federal agency to be honored and obeyed, if not loved.

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