

CRS Report for Congress

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Insurance Regulation in the United States and Abroad

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Baird Webel
Analyst in Economics
Government and Finance Division

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Summary

In the past two or three decades, a variety of technological and economic changes have caused significant upheavals in the global financial services industries. While this is perhaps most obvious in the new products and new companies (or merged older companies) that have come onto the market, it can also be seen in the changes made to the laws and regulatory structures that govern the financial services firms.

In the United States, the Gramm-Leach-Bliley Act (GLBA) of 1999 significantly changed the legal requirements applicable to insurers, banks, and securities firms, while leaving the structure of the regulatory agencies for those industries essentially unchanged. For both the securities and the banking industry, this has proven relatively uncontroversial, as both industries had established national systems of regulation. The insurance industry in the United States, however, has no national system of regulation — the 1945 McCarran-Ferguson Act gave regulatory authority to the individual states. This state-based system has proven controversial with some in Congress calling for federal reform of the system. The 107th and 108th Congresses both saw legislation introduced to allow for, or mandate, federal licensure and regulation of insurance companies. Such legislation has been introduced in the 109th Congress in the form of S. 2509, the “National Insurance Act,” by Senators John Sununu and Tim Johnson.

Internationally, many countries have also reacted to the technological and market changes by changing their legal and regulatory systems, with many countries completely reworking their regulatory structures. The changes made to the regulatory systems abroad have in many cases been significantly broader than in the United States. Some countries have created single regulators with broad powers to oversee the entire financial services industry. Others have instituted a so-called “twin peaks” model, whereby regulation of banks, insurers, and securities is combined, but there are two different functional agencies — one focusing on prudential regulation and another focusing on market conduct.

Another area of significant difference among countries is what occurs should prudential regulation fail and an insurer become insolvent. Some countries have instituted guaranty funds that would pay policyholders in the event of an insolvency, while others have no such systems. Many of the various changes abroad might illuminate the choices that Congress could face if it chooses to address the U.S. insurance regulatory structure.

This report will first give a statistical overview of various countries and then present a summary of U.S. insurance regulatory structure. Following this is an examination of insurance regulation in European Union as a whole, as well as the individual regulatory structures in three EU members (United Kingdom, the Netherlands, and Germany). This report also provides summaries of the systems in Canada, Australia and Japan. It will be updated only in the event of significant legislative developments in Congress.

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Insurance Regulation in the United States and Abroad

In the past two or three decades, a variety of technological and economic changes have caused significant upheavals in the global financial services industries. While this is perhaps most obvious in the new products and new companies (or merged older companies) that have come onto the market, it can also be seen in the changes made to the laws and regulatory structures that govern the financial services firms. In the United States, the Gramm-Leach-Bliley Act (GLBA) of 1999¹ significantly changed the legal requirements applicable to insurers, banks, and securities firms, while leaving the structure of the regulatory agencies for those industries essentially unchanged. Other countries have also changed their legal and regulatory systems, with many countries completely reworking their regulatory structures.

While GLBA repealed Depression-era laws mandating the legal separation of banking, securities, and insurance companies, it left the basic regulatory structure for these industries intact. For both the securities and banking industry, this has proven relatively uncontroversial, as both industries had established national systems of regulation. The insurance industry in the United States, however, has no national system of regulation — the 1945 McCarran-Ferguson Act² gave regulatory authority to the individual states. This state-based system has proven controversial with some in Congress calling for federal reform of the system. GLBA itself included federal insurance reforms with provisions that would have created a National Association of Registered Agents and Brokers (NARAB) if the state insurance regulations were not modified to allow for nonresident agent and broker license reciprocity between states. The NARAB provisions ultimately did not take effect, but congressional interest in the issue has continued. The 107th and 108th Congresses both saw legislation introduced to allow for, or mandate, federal licensure and regulation of insurance companies. Legislation creating an optional federal system has been introduced in the 109th Congress in the form of S. 2509, the “National Insurance Act,” by Senators John Sununu and Tim Johnson.³

Internationally, many countries have also reacted to the technological and market changes by changing their legal and regulatory systems, with many countries completely reworking their regulatory structures. The changes made to the regulatory systems abroad have been in many cases been significantly broader than in the United States. Some countries have created single regulators with broad powers to oversee

¹ P.L. 106-102, 113 Stat. 1338, 15 U.S.C. 6801 *et seq.*

² P.L. 79-15, 59 Stat. 33, 15 U.S.C. 1011 *et seq.*

³ See CRS Report RL32789, *Modernizing Insurance Regulation*, by Baird Webel.

the entire financial services industry. These single regulators generally oversee both prudential and market conduct regulation of financial firms. Prudential regulation revolves around seeing that firms remain financially sound and able to fulfill future promises. This often involves specific oversight of both assets and liabilities of financial firms. Market conduct regulation revolves around how the firms interact with customers. Countries have also instituted a so-called “twin peaks” model, whereby regulation of banks, insurers, and securities is combined, but there are two different functional agencies — one focuses on prudential regulation while the other focuses on market conduct.

Another area of significant difference among countries is what occurs should prudential regulation fail and an insurer become insolvent. Some countries have instituted guaranty funds that would pay policyholders in the event of an insolvency, while others have no such systems. Many of the various changes abroad might illuminate the choices that Congress could face if it chooses to address the U.S. insurance regulatory structure.

This report will first give a statistical overview of the various countries and then present a summary of U.S. insurance regulatory structure. Following this is an examination of insurance regulation in European Union as a whole, as well as the individual regulatory structures in three EU members (United Kingdom, the Netherlands, and Germany). This report also provides summaries of the systems in Canada, Australia and Japan. For each country, the report addresses the following principle questions:

- Is there combined regulation of banks/securities/insurers or do different agencies regulate the different firms?
- Is regulation, including prudential regulation and market conduct regulation, split between national and regional levels?
- Is the regulation for solvency and for market conduct under the same agency or split?
- Is there regulation of the prices of insurance and the policy forms that are used? Is there different regulation in this regard for different types of insurance?
- Is there a guaranty fund in the case of insurer failure? If so, is it private or public? Mandatory or voluntary? How is it funded? Does it build up a balance, or is the funding post-failure?

These questions are designed to shed light on the issues arising out of the current efforts to change the system in the United States. The first three points are fairly clear, focusing on who carries out the regulation. The fourth addresses one of the central issues in the debate in the United States, where industry group are strongly against the substantial rate and form regulations that exist at the state level, whereas consumer groups are equally adamant that this regulation is necessary for consumer protection. The final point is meant to illuminate a key issue if the United States were to institute a federal charter for insurance companies, namely what might be

done with the current system of state guaranty funds that protect policyholders in the event of an insolvency.

Table 1. Statistical Comparison of the United States, the European Union, the United Kingdom, Germany, the Netherlands, Canada, Australia, and Japan

	Population (Millions)	GDP (\$ billions)	Total Insurance Premium Volume (\$ billions)	Total Premium Volume per capita (\$)	Market Share of Foreign Insurance Firms
United States	292.4	\$11,734	\$1,108.1	\$3,790	21.2%
EU	457.2	\$13,098	\$1,116.8	\$2,443	NA
UK	59.4	\$2,132	\$288.6	\$4,859	32.1%
Germany	82.5	\$2,745	\$191.0	\$2,315	14.2%
Netherlands	16.3	\$608	\$60.4	\$3,706	22.4%
Canada	31.9	\$991	\$70.3	\$2,204	19.9%
Australia	20.0	\$616	\$49.5	\$2,475	NA
Japan	127.1	\$4,702	\$492.5	\$3,875	20.1%

Source: SwissRe, *World Insurance in 2004*; market share data is 2003 data from the OECD.

Notes: Total Premium Volume per capita calculated from columns two and four. NA indicates not available.

United States

The insurance regulatory system in the United States dates to the middle of the 19th century. The first landmark was an 1868 Supreme Court decision⁴ determining that insurance did not fall under the interstate commerce clause of the Constitution. This decision left regulatory power to the individual states which created their own regulatory bodies and statutes in the following years. While the precise nomenclature differs from state to state, most have some division of the state government with specific oversight and regulatory responsibility for insurance companies. The heads of these insurance departments (often known as insurance commissioners) are generally either elected in statewide elections or appointed by the governor. A private association of insurance commissioners, now known as the National Association of Insurance Commissioners (NAIC), was created in 1871, largely to help coordinate and harmonize insurance regulation among the states.

⁴ *Paul v. Virginia*, 75 U.S. (8 Wall.) 168 (1868).

In 1944, the Supreme Court reversed its earlier decision and found that insurance was interstate commerce and thus subject to federal regulation — in particular, to the federal antitrust laws.⁵ This provoked a quick reaction from both the industry and the state governments who prevailed upon Congress to pass the McCarran-Ferguson Act of 1945, which specifically granted the states the authority to regulate insurance and granted a limited exemption from the federal antitrust laws. There has been limited federal intrusion into the insurance regulatory system over the past 60 years,⁶ but while bills have been introduced in various Congresses to provide the federal government increased general regulatory authority over insurance, none has been enacted. In general, therefore, the states continue to exercise primary authority to regulate insurance in the United States.

The precise aspects of insurance regulation among the 50 different states, plus the District of Columbia and four territories, differ substantially. The NAIC and the National Conference of Insurance Legislators (NCOIL) produce model laws on various topics, and the NAIC has been very active in promoting other steps, such as a single point of electronic filing for insurance forms and an interstate compact to create uniform standards for life insurance products.⁷ Neither NCOIL nor NAIC, however, has any real authority to compel states to enact laws that are in line with their standards.

In general, insurance is highly regulated in the United States on both prudential and market conduct grounds. Market conduct regulation frequently differs among lines of insurance, with commercial insurance being less regulated than insurance purchased by individuals. States require licenses for insurance companies, brokers and agents, including separate licenses for insurers who are headquartered in another state. For some types of insurance, particularly compulsory lines, such as workers compensation and auto, many states have created some form of state insurance entity or enacted specific regulations to ensure that this insurance is available.

State regulation of rates and forms has been a major issue for insurance companies and for groups representing insurance consumers. Some in Congress have called specifically for federal preemption of state control of insurance rates,⁸ while others would extend rate and form regulation to the federal level.⁹ The exact type of state regulation varies significantly. It extends from strict “prior approval,” in which any rate change must be approved in advance, to a “no-file” system, where there is no direct oversight of rates. In between are approaches such as “flex rating,” “file

⁵ *U.S. v. South-Eastern Underwriters Association*, 322 U.S. 533 (1944).

⁶ See CRS Report RL32176, *The Risk Retention Acts: Background and Issues*, by Baird Webel.

⁷ For additional information on the NAIC modernization efforts, see June 16, 2005 testimony of the NAIC before the House Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises at [<http://financialservices.house.gov/media/pdf/061605mdk.pdf>].

⁸ See, for example, Representative Richard Baker’s website at [<http://baker.house.gov/html/content.cfm?id=408>]

⁹ Senator Ernest Hollings’ S. 1073 in the 108th Congress.

and use,” and “use and file,” which allow insurers some flexibility to change rates while still requiring some filing with the state insurance regulator. The Insurance Information Institute lists 31 states with prior approval requirements for at least some lines of insurance and 30 states (plus the District of Columbia) with no filing requirements for at least some lines of insurance.¹⁰ Most states have some lines that fall between the two extremes as well.

Insurance guaranty (or guarantee) funds have been created in every state to provide protection for policyholders in case of an insurer insolvency. Participation is generally a requirement for licensure in each state. These funds are generally run by the state departments of insurance and are responsible for satisfying claims against an insurer once an insurer is declared insolvent by the state’s insurance commissioner. Most of the state guaranty funds rely on post-hoc assessments on insurers operating in the state to pay for policyholder claims that are beyond the insolvent insurer’s remaining assets. The one exception to this is New York’s fund, which does pre-fund to some extent.¹¹ Should a multistate insurer become insolvent, the insurer’s home state fund takes the lead in managing the insolvency, but the other states’ funds are responsible for settling the claims that arise from within their state.

European Union¹²

Since it began as an agreement covering only the coal and steel industries of six European countries, the EU has expanded both geographically (25 current members) and into other economic and political spheres, including insurance regulation. In most areas where the EU exerts influence on member state laws, one sees a mix of (1) harmonization of national laws and laws enacted by the EU¹³ (known as “directives”) and (2) mutual recognition by the EU member states of the laws or regulations that are in place in other EU member states.

¹⁰ Insurance Information Institute website, *Rates and Regulation*, at [<http://www.iii.org/media/hottopics/insurance/ratereg>].

¹¹ See CRS Report RL32175, *Insurance Guaranty Funds*, by Carolyn Cobb, for additional information on guaranty funds in the United States.

¹² See CRS Report RS21372, *The European Union: Questions and Answers*, by Kristin Archick, for an overview of the European Union.

¹³ While an EU directive is enacted in a legislative process, it does not directly preempt individual national laws, as a federal law might do to state law in the United States. Instead, an EU member state’s government is required to enact a law harmonizing that member state’s national laws with the EU directive. An imperfect analogy in the United States’s insurance regulation would be that of the model laws that are adopted by the National Association of Insurance Commissioners, which must then be enacted by the state legislatures to take effect. The key difference, however, is that EU member states are required by international treaty to enact laws following EU directives, whereas U.S. states are under little or no compulsion to enact NAIC model laws.

There is no direct regulation of insurers by the EU. However, directives on insurance regulation date back many years.¹⁴ In the 1990s, as part of the creation of the European “single market,” EU directives introduced mutual recognition based on common minimum standards of supervision and the system known as the “single passport” for insurers. Essentially, a licensed insurer in one EU member state is authorized to do business in any other EU state on the basis of a simple notification and without the requirement for a separate license. The one exception to this is for lines that are compulsory in a particular nation (e.g., auto insurance). Prudential regulation of EU insurers is the responsibility of the home member state, while market conduct responsibility is somewhat mixed. Contract law, which specifically governs the interpretation of insurance policies, is generally the domain of the country in which the contract is signed. EU directives specifically disallow any requirements for prior approval of rates and forms. Whatever market conduct regulation of insurers that might occur must follow the fundamental principle of “national treatment” — foreign insurers from within the EU are treated the same as national insurers. In 1999, the EU began a project to overhaul the entire regulatory structure for the financial services industry, known as the Financial Services Action Plan¹⁵ (FSAP). The insurance component of the FSAP has centered on two areas to date — solvency regulation and regulation of reinsurance.

EU-wide minimum solvency requirements for property/casualty insurers were first established in 1973, and for life insurers in 1979. These standards were relatively low and were not updated until after the beginning of the FSAP. The so-called Solvency I directive, adopted in 2002, updated and indexed the minimum requirements for inflation and generally increased the minimum capital needed by insurers. Solvency I also introduced some risk-based capital requirements and allowed regulators to take action in cases where an insurer’s financial position was deteriorating even if it continued to meet the minimum requirements. While Solvency I certainly strengthened the requirements, it did not change the framework of the previous directives to a large degree; it essentially just changed the formulas that were in place. As suggested by the title, however, Solvency I was not the end of EU directives regarding this issue. Solvency II has been proposed to be much broader than Solvency I. “It contains a fundamental and wide-ranging review of the current regime in the light of current developments in insurance, risk management, finance techniques, financial reporting, etc.”¹⁶ Solvency II is currently envisioned to be adopted in July 2007 and to codify and replace the previous directives on insurance, including Solvency I and the directive on reinsurance. While drafts of the directive can be found on the EU website,¹⁷ the new standards remain a work in progress.

¹⁴ The first directive on solvency, for example, was issued in 1973 and the first on the establishment of insurance companies in 1964.

¹⁵ See CRS Report RL32354, *European Union — United States: Financial Services Action Plan’s Regulatory Reform Issues*, by Walter Eubanks, for a more complete overview of the FSAP.

¹⁶ *Solvency 2*, European Union website, available at [http://europa.eu.int/comm/internal_market/insurance/solvency2/index_en.htm].

¹⁷ *Ibid.*

The most recent insurance directive, adopted in September 2005, is on harmonizing regulation of reinsurance. Previously reinsurance was not the subject of EU-wide regulation. The reinsurance directive essentially applied the single passport framework, under which primary insurers operate, to reinsurers. Thus, a reinsurer domiciled in one EU country is now able to operate throughout the EU without hindrance except for supervision by its home country regulator. The directive contains specific prudential requirements that national regulators are to apply in overseeing reinsurers, including regulation of reinsurer investments. Of particular note, it also requires the removal of any national collateral requirements that had been applied by one EU member state on companies from another EU member state. This removal is significant since the existence of U.S. collateral requirements has been a matter of contention between European reinsurers and U.S. regulators. By removing all internal collateral requirements, the EU strengthens its argument against U.S. collateral requirements. The EU has specifically cited a desire to improve access to foreign markets as a rationale for adopting the reinsurance directive.

Over the past few years, there has been a significant amount of work done on the idea of an EU directive governing insurance guaranty funds. To this point, however, no conclusion has been reached about either the desirability of such a directive or what the precise contents of such a directive might be. Many of the EU member states have no national guaranty funds in place, although some have implemented such funds in the same time frame that discussions at the EU level have taken place on the topic.

United Kingdom

Following the country's tradition of unitary government, regulation of financial institutions is generally carried out centrally. Today, financial institutions, including banks, insurers, and securities firms, are regulated by the Financial Services Authority (FSA), an independent, nongovernmental agency afforded statutory powers to regulate the financial services industry. The FSA was created in 1997 following a change in the UK's government. Reacting to many of the changes in the market, the new government expressed concerns that the old system was costly, inefficient, and confusing to both customers and the regulated institutions. In addition, the drive to create a new regulator was also spurred by scandals, such as the failure of Barings Bank and the "mis-selling" of pension products.

The FSA initially consolidated nine banking and securities regulators under a single institution. Before 1997, the Department of Trade and Industry oversaw the prudential aspects of life and property/casualty insurance. Following four years of interim arrangements, the FSA obtained full statutory powers in 2001, when the Financial Services and Markets Act of 2000 (FSMA) came into force. While the market conduct of life insurers selling investment products was supervised since the late 1980s, statutory supervision by the FSA of the market conduct of property/casualty ("general") insurers was introduced in January 2005. This followed the implementation by the UK of an EU directive on insurance intermediaries. Prior to 2005, the sale and marketing of property/casualty insurance was overseen by General Insurance Standard Council (GISC), an industry self-regulatory organization.

The FSA is now the sole direct regulator for insurance in the UK. It has responsibility for both prudential and market conduct regulation. Its approach is an integrated one, encompassing both regulatory aspects within the insurance directorate of the agency. On the prudential side, regulation by FSA takes a “proactive, risk-based”¹⁸ approach. It also focuses significant attention on the managerial soundness and internal controls of individual companies. On the market conduct side, the focus is on accurate disclosures by the companies to consumers and fair treatment of customers, both pre- and post-sale. FSA has the legal authority to review insurance contracts for “unfair” terms and indicates that it will take action, working with insurance firms “where possible,”¹⁹ to change these terms if found to be inappropriate. The FSA does not intervene in individual cases between the policyholder and an insurer. This is left to the court system or an independent ombudsman as discussed below. There is no rate regulation of any kind.

While FSA is the sole direct regulator, there are two other bodies that have some influence on insurance regulation in the UK. Coming from above, as previously discussed, are the European Union’s various directives on insurance. Laws and regulations in the UK are required by the EU treaties to comply with these directives, and the UK has generally done so in the time frame that is required by the EU. The other agency that could have some effect on the consumer side of FSA’s insurance regulation is the UK Financial Ombudsman Service (FOS). The FOS was created by statute as an independent nonbinding arbiter of consumer complaints outside of the court system. Essentially, it examines complaints brought by a consumer and attempts to mediate a solution; if mediation fails, an arbitrator then makes a decision on an appropriate remedy. The firm involved in the dispute must accept the ombudsman’s decision up to a limit of £100,000 (approximately \$180,000).²⁰ The consumer involved has the option of rejecting the settlement and opting for the court system to settle the dispute. The FOS is funded through fees and assessments on the financial services industry; there is no charge to consumers for bringing a complaint. Although the FOS focuses solely on individual cases, it has been recognized that some FOS decisions could have a wider impact. The FSA and FOS have signed a memorandum of understanding on how to jointly proceed in such cases.

In 2000, a guaranty fund, the Financial Services Compensation Scheme (FSCS), was created as provided for by the FSMA. Although a separate entity, the FSCS covers the range of businesses (banks, insurers, insurance brokers, mortgage banks, investment firms) that are regulated by the FSA. The FSCS operates on a pay-as-you-go basis, with assessments levied each year on the industry based on expected need for the upcoming year. Each of the five industry groups has its own “sub-scheme” and assessments are based on the amounts needed for each industry. There is no cross-industry subsidization as, for example, between healthy banks and insolvent insurers. Each industry group has particular rules and limits for claims with

¹⁸ UK Financial Services Authority, *The Future Regulation of Insurance: a Progress Report*, available at [http://www.fsa.gov.uk/pubs/policy/bnr_progress3.pdf], p. 45

¹⁹ *Ibid.*, p. 29.

²⁰ All U.S. \$ estimates use 2005 exchange rates from the *CIA World Fact Book*, available at [<http://www.cia.gov/cia/publications/factbook>].

a general preference towards paying smaller claims in full. In non-compulsory general insurance, for example, the FSCS pays in full the first £2,000 (approximately \$3,600) and then 90% of the remaining claim.

Germany

Germany's federal structure gives significant sovereignty to its 16 states while retaining large areas of governance for the federal government. The majority of supervision over all financial services is done by the federal government; however, insurance regulation is legally shared with the states. The Federal Financial Supervisory Authority (BaFin²¹) is the primary federal regulator for financial services. BaFin was created in 2002 out of three previous regulators for banking, securities, and insurers. It is responsible for overseeing all private insurers that are of "material economic significance,"²² as well as any state-run or other public insurers that operate in more than one state. The states are responsible for single-state public insurers and small private insurers. As with other EU states, Germany is responsible for harmonizing its insurance law with EU directives.

Although now a single entity, BaFin continues to have three separate structures overseeing banks, securities firms, and insurers. It has created cross-sectional departments on issues such as overall financial stability, risk analysis, and consumer issues. BaFin is responsible for both prudential and market conduct issues for federally regulated insurers and insurance intermediaries. Insurers may engage only in insurance and insurance-related activities, and there must be legal separation between life and property/casualty insurers. Banks and insurers may be associated under the same holding company structure. BaFin conducts onsite examinations and has wide-ranging powers in cases where a company violates either market conduct or prudential standards, going as far as replacing the company's management or shutting a company down. Following EU directives, there is no prior approval of either rates or forms, but BaFin does have the authority to examine forms that are in use for consistency with consumer protection laws. For example, there must be a "cooling off" period with life insurance policies where the insured can cancel the policy with no penalty and there are various disclosure requirements as well. BaFin does not have the authority to intervene in specific consumer complaints, and there is no government-sponsored ombudsman, as in the UK. There are, however, private ombudsman services that seek to fill the same role, providing an alternative dispute resolution service. With the private services, companies are bound to accept the ombudsman's decision, but only up to the sum of €5,000 (approximately \$6,200), less than 5% of the amount in the UK.

Germany has a private industry-run guaranty fund for the life insurance industry, which began in 2002. Participation in the life insurance fund, Protektor AG, was initially voluntary but is now mandatory for German life insurance companies. The fund operates on industry assessments that are calculated according to company size. It is pre-funded, with approximately €240 million (approximately \$300 million) in

²¹ From the German "Bundesanstalt für Finanzdienstleistungsaufsicht."

²² BaFin website, *Responsibilities and Objectives*, available at [http://www.bafin.de/bafin/aufgabenundziele_en.htm#n9].

assets in 2005 due to an earlier insolvency. In the future, the fund is intended to increase to a maximum of €500 million (approximately \$620 million). As these assets are drawn upon, the fund is to be recapitalized from the industry, up to the maximum of €500 million per year. There is no guaranty fund for property/casualty insurers. It is possible that other insurers might step in and take over an insolvent insurer, but there is no legal requirement that this occur.

The Netherlands

Following significant legal and market changes during the previous two decades, including the removal of a prohibition on bank-insurer mergers in 1990, the Netherlands began reforming its financial services regulation in 2002 and largely completed the reform in 2004. Three previously separate regulators, the Dutch central bank (DNB), the pension and insurance supervisor and the investments board, were consolidated into two regulators operating on the “Twin Peaks” model that was pioneered by Australia a few years before. One regulator, the DNB, was made responsible for prudential regulation, while a second, the Authority for Financial Markets (AFM) was created to oversee market conduct regulation.

The DNB and the AFM are the only direct regulators of insurance in the Netherlands. Due to the country’s size and unitary governmental structure, there are no sub-national structures playing a role in insurance regulation. The DNB licenses insurers separately for seven different life insurance lines and 18 different non-life insurance lines. A specific legal entity cannot hold both a life and non-life insurance license. The DNB has authority over all aspects of prudential regulation, including testing for solvency, capital requirements, and investment rules. It is implementing a fair market value standard for both assets and liabilities and increasing its attention to the fitness and trustworthiness of company management. In the case of insurer difficulty or insolvency, it is authorized to direct an insurer to take specific steps to protect policyholders or can go as far as appointing a receiver for the company and liquidating the company to pay off policyholders’ claims. The costs relating to insurance oversight are funded by the insurance industry.

The AFM oversees the market conduct of insurers and insurance intermediaries. It issues licenses for those dealing with insurance consumers. Oversight by the AFM is largely limited to enforcing information disclosure about insurance policies, with extra disclosure required for policies with an investment component. It does not have authority to regulate insurance forms or rates. The AFM is funded through levies on the industries it oversees proportionate to the cost of the oversight.

There is no insurance guaranty fund in the Netherlands.

Canada

While much smaller than the United States, Canada shares a somewhat similar federal structure with 10 provinces and 3 territories making up the country. The approach to insurance regulation, however, is much different than in the United States. In Canada, both the federal and provincial levels share the legal power to

charter and regulate insurers although some de facto specialization at the different levels has occurred.

On the federal level, the Office of the Superintendent of Financial Institutions (OSFI) has authority over all federally chartered financial institutions. OSFI was created in 1987 through a merger of separate offices overseeing banks and insurers. OSFI's focus is prudential oversight through the formation and application of regulations, ongoing risk assessment of financial institutions, and intervention when necessary to mitigate risk. Canadian law regarding financial regulation is reviewed every five years. In 2001, this periodic review resulted in new legislation strengthening OSFI's position as the primary federal regulator and increasing its oversight powers. Part of the reason for increased powers was a change in the legal structure for financial institutions allowing increased concentration, including, for example, a holding company structure under which banks and insurers can be owned by the same entity. Also in 2001, a new agency, the Financial Consumer Agency of Canada (FCAC), was created to enforce federal consumer protection laws and promote consumer education. OSFI remains the prudential regulatory body and is the larger of the two entities. According to their websites,²³ OSFI employs approximately 425 people, while FCAC employs 35. Both agencies receive their funding primarily through assessments and fees on the institutions they regulate.

While OSFI and FCAC regulate at a federal level, each province or territory has legal authority to regulate provincially chartered insurers for both solvency and market conduct. The provinces and territories also have the authority to regulate the market conduct of federally chartered insurers, including requiring provincial licenses and reviewing forms. The precise structure varies between the different provinces and territories. Some have a separate agency for financial institutions; some regulate through the Department of Finance or Attorney General. The Canadian Council of Insurance Regulators (CCIR) serves a similar function to the NAIC in the United States, seeking to "develop and harmonize insurance policy and regulation across jurisdictions."²⁴ Like the NAIC, however, the CCIR has no authority to compel provinces and their regulators to follow its efforts at harmonization.

The legal structure may appear very duplicative, with both levels of government having somewhat overlapping oversight powers. The system, however, has largely developed into a split system wherein the federal government oversees the solvency regulation of almost all insurers, even provincially chartered ones, and the provinces oversee the market conduct regulation of all insurers. OSFI provides oversight of more than 90% of life insurance companies and more than 80% of property and casualty insurance firms, as measured by assets. Some of this split is due to the fact that many insurers, particularly life and health insurers, have chosen to be federally chartered, which puts them solely under OFSI for solvency regulation. But it is also due to the choice by three of the provinces — including the largest, Ontario — to voluntarily accept federal oversight of the solvency of provincially chartered insurers. On the consumer side, the FCAC is a recently created agency and is mandated to

²³ [<http://www.osfi-bsif.gc.ca>] and [<http://www.fcac-acfc.gc.ca>].

²⁴ CCIR website, *About CCIR*, available at [http://www.ccir-crra.org/CCIR/about_ccir/index_en.htm].

ensure compliance only with federal consumer legislation. Given this and its relatively small staff, it seems to be expected that the bulk of consumer regulation will continue at the provincial level. One important difference when comparing the consumer regulation in Canada and the United States is the issue of rate regulation. While many U.S. states require prior approval for rate changes or otherwise regulate rates for many lines of insurance, rate regulation in Canada is limited solely to automobile insurance rates and not every province/territory regulates these rates.

Canada has two guaranty funds, one for property/casualty insurers, the Property and Casualty Insurance Compensation Corporation (PACICC), and one for life/health insurers, Assuris. While both funds are private entities run by the insurance industry, all property/casualty companies and nearly all life/health companies are required to be members as a condition of licensure. This applies to both provincially and federally chartered companies. The funds keep some liquid assets on hand, CDN\$120 million (\$104 million) for Assuris and CDN\$62 million (\$54 million) for PACICC, but otherwise operate on a post hoc basis — they would be bolstered by assessments on the insurance industry in the event of an insolvency that required more assets than remained on the books of the insolvent insurer. As is typical with many guaranty funds, the Canadian funds aim to ensure that smaller policyholders are protected to a greater degree than larger policyholders in the event of an insurance company failure.

Australia

Following significant deregulation of the financial system in the 1980s and early 1990s, Australia undertook reform of its financial regulatory bodies in the late 1990s. A Financial System Inquiry was created in 1996 and reported recommendations in 1997. Many of these recommendations were put into place in 1998, including the abolition of the previous bodies supervising insurance, banks, and securities and the creation of two new federal agencies to oversee all financial institutions. While the federal government is the preeminent insurance regulator, the six states and two territories retain authority to regulate two main classes of insurance: personal injury motor accident and workers compensation.

The two federal insurance regulatory agencies focus on different areas. The Australian Prudential Regulation Authority (APRA), as the name suggests, focuses on prudential regulation, ensuring that “financial promises made by institutions [APRA] supervise[s] are met within a stable, efficient and competitive financial system.”²⁵ APRA is responsible for granting and revoking insurer licences and has broad regulatory powers including setting minimum capital requirements, assessing insurer assets and liabilities, and reinsurance arrangements. Should an insurer become insolvent, APRA oversees the insolvency and the settling of the company’s affairs. APRA is largely funded through assessments and fees on the industry it oversees. The Australian Securities and Investments Commission (ASIC), focuses on the market conduct of all financial institutions. It is responsible for the licensing of insurance agents and brokers. Its enforcement power includes both investigating complaints brought by consumers and self-initiated investigations. It currently

²⁵ APRA website, *About APRA Home*, available at [<http://www.apra.gov.au/aboutApra>].

employs about 1,570 employees. ASIC is funded in the Australian federal government's general budget.

States play only a small part in regulating insurance in Australia. Their role is largely limited to two lines, personal injury motor accident and workers compensation. These two lines of insurance are compulsory for drivers and employers respectively. Some of the state governments have created state-run monopoly insurers to provide for the insurance. In others, there is state involvement in an insurer of last resort while allowing competition among private insurers for the rest of the market.

In general, there is relatively little rate and form regulation by Australian insurance regulators.²⁶ The primary exceptions to this, however, are the two lines that are state-regulated, particularly in those states that run monopoly insurers. Both rates and forms for personal injury motor accident and workers compensation are set by the state regulators. In the aggregate, the rates are generally set to match claims, so there is no direct public subsidy to insurance consumers for these two lines. Forms for some other lines — motor vehicle, home building and contents, sickness and accident, consumer credit and travel insurance — are governed by statute, with specific coverages and exclusions required. Other lines are essentially unregulated with regard to forms.

There is no guaranty fund in Australia. A technical study on the possibility of a fund was begun in 2004. No policy conclusions, however, have been reached. In the case of an insurer insolvency, the insurer's remaining assets are liquidated and policyholders' claims ranked with other unsecured creditors to be satisfied out of these assets. Policyholders do, however, enjoy priority with regard to any reinsurance proceeds subject to the discretion of the court. There is no priority for smaller policyholders.

Japan

Japan's financial services regulation, like the rest of the governmental structure, is centered in the national government in Tokyo. There is little sub-national regulation of financial services firms. In 1996, Japan implemented a significant deregulation of the financial sector and shortly thereafter began a restructuring of financial regulators. Prior to 1998, oversight authority for and regulation of private sector banks, insurers, and securities firms rested with the Ministry of Finance. In 1998, the Financial Supervisory Agency (FSA) was created under the direction of the Prime Minister's office. The FSA was made responsible for supervision and inspection of financial services firms. Its power was expanded in 2000 and 2001 with the addition of responsibility for overall planning for the financial system and authority to dispose of failed financial institutions. In 2000, the name was changed to the Financial Services Agency. Unlike many other countries that have restructured their systems, Japan did not combine previously separate regulators or change the functional competence of existing regulators. The creation of the FSA was largely

²⁶ There are standard forms, but an insurer can use make any changes to these forms as long as the changes are disclosed to the insureds.

a movement of the regulatory authority, and many of the staff, from the Finance Ministry to an independent agency. FSA was, however, given some authority that had rested outside of the Finance Ministry. This new authority included oversight of small credit unions which had been performed at a local level.

The FSA has complete authority for both prudential and market conduct regulation of all private insurers. All insurers and insurance intermediaries must be licensed, but licensure is not limited to single-purpose entities. Insurers may offer both life and non-life insurance products and subsidiaries of banks and commercial firms may apply for insurance licenses. The limitation to private insurers, however, is significant. The Japanese Post Office has acted as both a bank and a life insurer for many years. In 2005, it held almost 39% of the life insurance assets in the country.²⁷ A postal privatization law was passed in late 2005. When the Japan Post life insurance operation is privatized, it will come under FSA authority. Up to this point, however, this share of the market has not been regulated by FSA or the Ministry of Finance before it. In addition, there are cooperatives known as “kyosai,” whose estimated share of non-life insurance is as high as 25% of nationwide direct non-life premiums.²⁸ These cooperatives are not subject to FSA regulation, although legislation has been suggested to put them under the FSA umbrella. There are also government-run insurance programs, including the entire workers compensation insurance system and a reinsurance program for earthquake risks.

Prior to financial sector deregulation in 1996, insurers in Japan were required to follow the rates and forms published by cooperative rating bureaus and approved by the government. As part of the deregulation, this system was abolished. Now, rating bureaus publish suggested rates, but insurers are not required to follow them. Prior approval of forms has been replaced by a “notification system” allowing insurers to use forms after notifying and allowing FSA to review them. Specific regulation of rates and forms continues with the government-run or required lines of insurance (i.e., workers compensation, earthquake, and compulsory auto insurance).

There are guaranty funds for both non-life and life insurance in Japan. The Non-life Insurance Policyholders Protection Corporation of Japan was created in 1998. It is a private corporation that all private primary insurers, domestic and foreign, operating in Japan are required to join. Insurers are assessed according to premium volume. The corporation is intended to be pre-funded up to a maximum amount of ¥50 billion (approximately \$450 million), which is 10 times the annual maximum insurance industry contribution. Policy holders in insolvent insurers are guaranteed 100% of their claims for compulsory auto and earthquake insurance and 90% of claims for other eligible insurance lines (primarily personal lines). There is no preference for small policyholders, but many commercial lines, which tend to be

²⁷ Calculation by CRS from statistics found in Japan Post’s Postal Life Insurance annual book 2005 at [<http://www.japanpost.jp/top/disclosure/e2005/pdf/chapter6.pdf>], p. 152, and the Life Insurance Association of Japan’s website at [http://www.seiho.or.jp/english/Facts/balance_sheet.html].

²⁸ Hiroyoshi Wada, *Current Situation and Main Issues in the Japanese Non-Life Market*, available at The Non-Life Insurance Institute of Japan website at [<http://www.sonposoken.or.jp/english/market>].

larger claims, are not eligible for guaranty fund protection. The Life Insurance Policyholders Protection Corporation of Japan was also established in 1998. It is likewise funded by industry assessments, though should the fund not be sufficient to cover an insolvency, a direct subsidy from the government is possible. Policy holders would receive 90% of their claim.