Symbiotic Reform to Regulate the Insurance Industry: Regulators, Market Access, and Antitrust Issues in the U.S. and Korea

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SYMBIOTIC REFORM TO REGULATE THE
INSURANCE INDUSTRY: REGULATORS, MARKET
ACCESS, AND ANTITRUST ISSUES IN THE U.S. AND KOREA

Sung Keun Chun

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MAURER SCHOOL OF LAW, IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR

THE DEGREE OF DOCTOR OF JURIDICAL SCIENCE

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MARCH 24, 2010
DEDICATED TO MY PARENTS, MY WIFE, AND MY CHILDREN FOR THEIR PRAYER, SUPPORTS AND LOVE IN GOD.
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Finally, special thanks and love go to my family, especially my wife, Jumi. She supported me and devoted herself with patience and sacrifice. I also appreciate my law firm, Kim & Chang, for its continuous support.
This dissertation deals with different issues together: regulators, market access, and antitrust in the insurance industry in the U.S. and Korea. The insurance market is regulated by the state alone and more than 51 requirements exist to establish an insurance company in the U.S. The insurance industry is also statutorily exempted from federal antitrust laws in certain conditions under the McCarran-Ferguson Act, which is facing proposals to reveal or revise it from Congress. The appropriate licensing policy is important because it can contribute highly to social welfare and protect the market failure. The proper application of antitrust law with a reasonable insurance immunity is also crucial to pursuing market efficiency and maximizing consumer welfare. I believe the McCarran-Ferguson Act partially serves those goals although it requires some revision like enacting another Statute such as the Optional Federal Charter Act. I suggest creating a symbiotic regulatory scheme by establishing a new federal authority, creating an optional federal chartering system, and allowing antitrust regulation to maintain at the state level. To promote modernization and globalization as well as to prevent systemic risk and inefficiency, federal regulation of the insurance industry is essential. The optional federal charter for insurers can help efficient and unified market access, which also can limit the scope of the McCarran-Ferguson Act's exemption only for state-chartered insurers.
The Korean regulatory regime requires not only structural reform, but also enhanced symbiotic cooperation between the existing regulators: the FSC, FSS, KFTC and other regulatory authorities. The principle of checks and balances must be secured to promote regulatory competition and protect against regulatory failure. It must come along with clarifying the function and procedure by clarifying and observing the related Acts and MOUs. The anticompetitive policy to control the number of insurance companies by restricting the issuance of new licenses must be abandoned because it is not an effective policy for either insurance companies or consumers in Korea. The Korean competition policy, as applied to the insurance industry is necessary to provide clear legislative revision, judiciary arrangement, and executive cooperation, especially for resolving which administrative guidance is legitimate action.
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<td>AIG</td>
<td>American International Group</td>
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<td>FTA</td>
<td>Free Trade Agreement</td>
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<td>NAIC</td>
<td>National Association of Insurance Commissioners</td>
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<td>NARAB</td>
<td>National Association of Registered Agents and Brokers</td>
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<td>OFC</td>
<td>Optional Federal Charter</td>
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<td>FIO</td>
<td>Federal Insurance Office</td>
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<td>Korea</td>
<td>South Korea</td>
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<td>Troubled Asset Relief Program</td>
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<td>Non-bank Supervisory Authority</td>
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<td>BOK</td>
<td>Bank of Korea</td>
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<td>KFTC</td>
<td>Fair Trade of Commission Republic of Korea</td>
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<td>GLBA</td>
<td>Gramm-Leach-Bliley Act</td>
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<td>SMART</td>
<td>State Modernization and Regulatory Transparency</td>
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<tr>
<td>IBA</td>
<td>Insurance Business Act</td>
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<td>International Association of Insurance Supervisors</td>
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<td>FTC Act</td>
<td>the Federal Trade Commission Act</td>
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<td>Monopoly Regulation and Fair Trade Act</td>
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<td>GAO</td>
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Chapter 1: Introduction

I. Issues to reform the insurance industry

A. Overview of the issues

This dissertation deals with three separate, different issues together: regulators, market access, and antitrust issues in the insurance industry as well as those same issues in the U.S. and in South Korea (Hereinafter “South Korea” is referred to as “Korea”). Regulators and market access issues in the U.S. are pertinent to regulatory structure, which is state-based regulatory structure and is likely headed for reform by federal involvement. American insurance companies are exempt from the grasp of antitrust law, and the industry specific nature of the exemption begs repeal or revision. These three issues are based upon the McCarran-Ferguson Act, which created the legal regime and has provided legitimate grounds for the insurance exemption since 1945.

The same issues can be applied to the Korean legal system; however, direct application and comparison is impossible because Korea has neither a federal system nor the McCarran-Ferguson Act. Instead, Korea experiences regulatory conflict among regulators such as Fair Trade of Commission Republic of Korea (hereinafter referred to as “KFTC”) and Financial Supervisory Service (hereinafter referred to as “FSS”) regarding regulatory structure and the application of antitrust regulation. The anticompetitive licensing policy that denies issuance of new licenses is also problematic.
in Korea. The three issues of regulation, market access, and antitrust issues as expressed in America and Korea are reviewed in this dissertation separately and comparably although exact analogy is difficult.

The regulatory structure of the insurance industry is required to reform because efficient and effective regulation can contribute highly to social welfare and protect against market failure through social spending. In the big picture, conforming state regulation to federal regulation is desirable to develop the insurance market and regulatory skill. The proper application of regulation with reasonable exemption to the insurance industry is also crucial to pursue market efficiency and maximize consumer welfare. Because the McCarran-Ferguson Act has served to develop a healthy insurance industry, the U.S. should keep the McCarran exemption of the insurance industry while introducing an optional federal charter system. I will call this revision a “symbiotic\(^1\) approach to reform” because the federal and state regulatory authorities must cooperate in some situations and compete with each other in different situations to succeed.

The Korean regulatory structure not only requires reform, but also requires enhancement of the symbiotic approach between existing regulators before consolidating into one body from divided organizations: the Financial Services Commission (hereinafter referred to as “FSC”) and Financial Supervisory Service (hereinafter referred to as “FSS”). The principle of checks and balances must be secured to enhance regulatory competition as well as to protect against market failure. The anticompetitive policy to control the number of insurance companies by restricting issuance of new licenses must be abandoned because it is not an effective policy for both insurance companies and

\(^1\) From the Dictionary.com, “symbiotic” describes “any interdependent or mutually beneficial relationship between two persons, groups, etc.”, available at http://dictionary.reference.com/browse/symbiotic.
consumers in Korea. A Korean competition policy, as would be applied to the insurance industry, is not developed, but is nevertheless necessary to provide for clear legislative revision, judiciary decision, and executive cooperation. This principle is especially true for resolving the debate about whether administrative guidance is a legitimate action that should be exempted from competition law.

II. Challenges to reforming state-based regulation and the statutory antitrust exemption in the insurance industry

The legal basis to regulate insurance in the U.S. is the McCarran-Ferguson Act, which deals with regulatory authority and the federal exemption of insurance businesses to antitrust law. The McCarran-Ferguson Act is the basis for regulating the insurance system in the U.S., but now people are seeking another resolution. The unrest means that some part of the supervisory system could be changed for the insurance industry to meet the new challenges in the U.S. There are two important aspects contained in the McCarran-Ferguson Act: (1) the states supervise the insurance industry with limited exceptions, on the other hand the federal authority has main supervisory power to the other financial sectors, such as banks and securities firms, and (2) the insurance industry is exempted from federal antitrust regulation under certain conditions. These two issues have been debated from the beginning of the insurance business and will continued to be debated even after the change or repeal of McCarran-Ferguson Act because these issues

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2 From the McCarran-Ferguson Act the insurance market of U.S. has a character different from any other insurance market in the world. The insurance industry is governed by each state and exempted from federal antitrust acts under certain conditions.
can be approached differently with the development of financial capitalism, including the insurance business and based on the economic condition of each generation.

III. Mutual influence of and relationship between the United States and Korea

A. Overview of the insurance markets and business relationships in the U.S. and Korea

The U.S. has the largest market in the world, and Korea has the seventh largest market in the world. The insurance industry has a large influence on the U.S. economy. The U.S. insurance industry is a major source of jobs for U.S. citizens, employing 2.3 million people in 2000. In fact, from 1990 to 2000, employment in the insurance industry has averaged at about two percent of the total U.S. employment. Economic census data reveals that over 5,000 insurance carriers with combined revenues of $1.2 trillion operated in the U.S. and that time. Insurance payments constitute significant consumer payments in the U.S. An average American family can pay a combined total of $4,500 each year for health, life, auto, and home insurance products.

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3 As measured at the end of 2005, the insurance market in Korea was the seventh largest market in the world in terms of the size of the insurance premiums (USD 82,933 million). From the same statistics, the largest insurance market in the world was the U.S. (USD 1,142,912 million). See General Insurance Association of Korea, 2006 Fact Book, at 72.


The insurance industry also affects the general economy, even though it constitutes a relatively small portion of the U.S. financial service industry. At the end of 2006 insurers in the U.S held assets totaling $6 trillion, while banking sector assets and securities sector assets were $12.6 trillion and $12.4 trillion, respectively. The life insurers held cash and invested assets of $3 trillion, and property and casualty companies, which are major municipal bonds holders, held cash and invested assets of $1.3 trillion in 2007. Despite the difference in asset control, the insurance industry clearly affects the general economy; for example, even normal individual and business driving are impossible without daily insurance coverage.

In 2006, Korean insurance premiums reached $101.2 billion, constituting 11.1 percent of the GDP. At the end of 2007, insurance companies in Korea held assets totaling 222 trillion won, while banking assets were 1,568 trillion won and securities and asset management companies held assets totaling 264 trillion won. The driving force for the growth of the Korean insurance market has been active participation by foreign insurance companies. For example, U.S. insurance companies have been active in the Korean market. Active companies include: Prudential, MetLife, New York Life, American International Group, Inc. (hereinafter referred to as “AIG”), LINA, ACE, Federal, Chubb, and Genworth. On the other hand, the Korean insurance companies,

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6 See Guinn, Patricia L., HOW SHOULD THE FEDERAL GOVERNMENT OVERSEE INSURANCE?: HEARING BEFORE THE SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES OF THE COMMITTEE ON FINANCIAL SERVICES U.S. HOUSE OF REPRESENTATIVES, 111th Cong. 80 (May 14, 2009), (Prepared statements).


9 AIG in Korea changed the name of the company to AIA Life in 2009, available at www.aia.co.kr. Introduction of AIA Life in Korea.
although not as active as the U.S. insurance companies in the Korean market, have also been involved in the U.S. insurance market. Through their branch or liaison offices they engage in reinsurance transactions and gather information.\textsuperscript{10} Different types of insurance products are popular in the two countries. For example, in contrast to health insurance in the U.S., the Korean health insurance market is very small because basic health insurance is provided by the national government. Even in Korea, however, the private health insurance industry is awakening. One specific characteristics in Korea is the growth of quasi-insurance companies including post offices, Nonghyup (agriculture associations), and Shinhyup (credit unions); these quasi-insurance companies are large players in the insurance market. The Free Trade Agreement (hereinafter referred to as “FTA”) between the U.S. and Korea included debates whether the quasi-insurance companies should be well regulated by financial regulators, especially regarding a solvency standard to establish a level playing field for private insurance companies and otherwise it will be regarded subsidies from the government for the quasi-insurers to control competition with private insurers.

\textbf{IV. Regulatory systems and business models of America and Korea}

There is no national statute such as a federal insurance statute nor is there distinct, separate legal and regulatory treatment between insurance contracts and insurance business areas in the U.S. The general contract law, including common law, governs the

\textsuperscript{10} Eighteen Korean insurers do business in the U.S. through subsidiary, branch, or liaison offices in the U.S. market. \textit{See} FSS, Annual Report (2008), at 41.
insurance contracts in the states, but there are several exceptions and special provisions for insurance contracts in the U.S. However, there are two specific statutes in Korea: the Insurance Contract Law and the Insurance Business Act (hereinafter referred to as “IBA”); these statutes are separate, but related to each other. Insurance Contract Law is a part of commerce law and concerns the insurance contract, insurance business, and general terms and conditions. Insurance Commerce Law is included in the Commerce Act and deals with legal principles of insurance in Korea.

The objective of the Insurance Business Act, with due consideration to the public responsibilities of the insurance business, is to protect policyholders' interests by ensuring the sound management of insurance companies and the fairness of insurance soliciting activities, thereby contributing to the stability of people's lives and the sound development of the national economy. The Act gives the Korean government legal grounds to supervise and regulate the insurance industry, including licensing. IBA focuses on regulating the insurance industry and on the governance of the FSS, including organization and authorities.

V. Purpose, Approaches and Arguments

This dissertation introduces and examines the U.S. and Korean legal structures and regulatory regimes which can be good comparative tools to set up each country's reforms and to lead to further research. This dissertation also gives some recommendations and considers significant aspects of antitrust issues within the two
countries. This dissertation focuses on reviewing the past and current regulatory regimes and making recommendations for better regulatory legal frameworks and applications. Also this dissertation reviews each sub-section independently and compares differences in legal frameworks, statutes, character, and policies of the U.S. and Korea.

This dissertation is written on three separate, but related subjects: regulators, market access, and antitrust issues in the insurance industry. Regulators and market access are topics that concern the type of regulatory authority in a market, such as federal versus state regulation and separate versus consolidated supervision in the U.S. and government versus quasi-government organization in Korea. The antitrust topic considers the exemption of the insurance industry to antitrust law. The systems, statutes and related cases law are reviewed and compared in this dissertation. Related debates, cases, and articles are also analyzed and commented upon.

12 In addition to Korea, Denmark, Norway, Sweden, German, Japan, Singapore, and the U.K. have consolidated supervisors who are responsible for entire financial service sectors.

13 A 2006 survey by the International Association of Insurance Supervisors (hereinafter referred to as “IAIS”) shows that Canada-Quebec, Malaysia, Indian Insurance Regulatory Development Authority, and FSS institution of Korea are examples of quasi-government authority.
## Chapter 2: Challenges to repealing the McCarran-Ferguson Act

### I. History of state regulation and the McCarran-Ferguson Act

#### A. Beginning of the insurance industry: no specific regulation

Benjamin Franklin is known to have helped establish the insurance industry in the United States by organizing the Philadelphia Contributionship for the Insurance of Houses from Loss by Fire in 1752.\(^{14}\) State-based regulation of insurance originated in the 19\(^{th}\) century when New Hampshire appointed the first insurance commissioner in 1851.\(^{15}\) There was no specific regulation of colonial insurance until 1868.\(^{16}\) Even after 1868, the regulation was minimal—just for incorporation requirements to organize an insurance company and offer to coverage. When the insurance business reached the state territories, insurance corporations had to be set up by special legislation because states did not provide general corporate acts, yet at that time. Regulators could limit the number of insurers and place the insured at a bargaining disadvantage. Regulation to access outside markets, especially of foreign entities and alien suppliers,\(^{17}\) was established in many states. For example, New York, Virginia, Maryland, and Pennsylvania tried to protect

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\(^{15}\) *Id.*

\(^{16}\) In 1868, the United States Supreme Court held in *Paul v. Virginia* that state insurance did not violate the Commerce Clause because insurance policies were “simple contracts of indemnity” which “are not articles of commerce in any proper meaning of the word.” See 75 U.S. 168 (1868).

\(^{17}\) The terms of foreign and alien are used in reference to entities, companies, suppliers or insurers. Foreign entity means the entity is domiciled in another state, and alien entity means the company is incorporated in another country in general.
local insurers from foreign and alien companies because the local insurance companies were a key source of state revenues. Discriminatory insurance taxes were common to the states until 1985; however, the Supreme Court decided that such a taxation practice was not the purpose of state regulation and was also a violation of the Equal Protection Clause of the Constitution.\(^\text{18}\)

B. Insurance business was not commerce: state regulation of insurance

In 1869, the U.S. Supreme Court held that the insurance business did not constitute interstate commerce, so local transactions could be regulated by state authority.\(^\text{19}\) The Court’s conclusion gave state governments a basis for strengthening their regulatory foundations. In 1871, insurance regulators established the National Insurance Convention, the predecessor of the National Association of Insurance Commissioners (hereinafter referred to as “NAIC”), and started to systematically organize their regulatory tools, including standardization of policy. The government maintained a market condition that produced industrial growth and reasonable profits. Somehow the welfare of the public was sacrificed for the interest of the private company.

Insurance was not considered interstate commerce according to *Paul v. Virginia*\(^\text{20}\) (hereinafter referred to as “*Paul*”) until the Supreme Court overruled the case in *United


States v. South-Eastern Underwriters Association21 (hereinafter referred to as “SEUA”). According to Paul, several New York-based fire insurers hired Samuel Paul as agent in Virginia. When Samuel Paul refused to deposit the licensing bond, however, Virginia denied him a license to sell insurance, which lead to his conviction for selling policies.22 On appeal, Paul argued that Virginia’s laws violated the Commerce Clause and the Privileges and Immunities Clause of the United States Constitution.23 However, the Supreme Court upheld Paul’s conviction against the challenge that insurance was within the interstate commerce clause. The Court highlighted the “contracts of insurance,” which Paul issued, and held that these contracts were not commerce since they could not be offered for trade in a market or be shipped from one state to another like a commodity.24

Early state insurance departments regulated licensing of the companies, brokers, and agents; imposing taxes and fees; and receiving financial reports.25 As the volume of the insurance business increased, especially the fire-insurance industry, the states had difficulty regulating its business activities. Competition among fire-insurance providers

resident of Virginia, was arrested and fined for issuing policies on behalf of the unlicensed New York insurers.

21 322 U.S. 533 (1944).


23 Id. at 631.

24 See supra note 18, at 183. This decision suggested that the federal government was not able to exercise authority over insurers under the Commerce Clause, but could exercise federal authority by the other constitutional powers. See also Raymond A. Guenter, REDISCOVERING THE MCCARRAN-FERGUSON ACT’S COMMERCE CLAUSE LIMITATION, Connecticut Insurance Law Journal (1999-2000), at 7.

was enormous and none of the insurers paid enough attention to risk management and prudent asset management. Thus, when major fires occurred, many insurers did not pay the claims and instead announced bankruptcy. The insurance industry adopted a solution by setting rates collectively for premiums and agent fees. This encouraged the establishment of regional rating offices and the National Bureau of Fire Underwriters in 1866. The states then prohibited collective ratemaking to enact anti-compact laws and also established the National Association of Insurance Commissioners (NAIC) in 1871 to cooperate among state commissioners on a nationwide basis. However, after the San Francisco earthquake of 1906 and the bankruptcy of many insurers, the remaining insurers sharply raised the rates. States such as New York determined that rate competition and the subsequent low premium-rates caused the insolvency against big natural disaster. Thus states allowed collective rates for insurers through an industry rate bureau.

C. Enacting the McCarran-Ferguson Act: protecting states and insurance businesses

In 1944, the Supreme Court held that the insurance business was interstate commerce, making the insurers and their employees subject to the Sherman (Antitrust) Act. The resolution supported the criminal indictments in the District Court against

27 See Meier, Supra note 26, at 51.
28 See Raymond, Supra note 24, at 14.
29 See Day, supra note 25, at 18-20, see also Raymond, supra note 24, n. 169. Collective rates were not allowed for all lines of property and casualty nor for life insurance.
almost 200 stock fire insurers and 27 individuals for violation of the Sherman Act. The defendants were charged for restraining interstate trade and commerce by fixing and maintaining arbitrary, noncompetitive premium rates on fire and other insurance and for monopolizing trade and commerce. The South-Eastern Underwriters Association was a rating bureau that controlled 90 percent of the five markets in six states. The case also challenged the constitutionality of the state regulatory system, including licensing and taxing. This decision initiated and fueled the passage of the McCarran-Ferguson Act.

In 1945, the U.S. Congress passed the McCarran-Ferguson (Insurance Regulation) Act to assure the primary responsibility for insurance regulation to the state department and away from the political pressure of the states. This Act was upheld as constitutional by the Supreme Court in 1946. The Act permitted continued state regulation of

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30 See SEUA, 322 U.S. at 354, 534 (1994).
31 The defendants were indicted for using boycotts, coercion, and intimidation to force companies and agents to accept the rates set by the association. Although state law did not sanction the above practices, the state law that authorized collective ratemaking might violate the federal antitrust laws. See Day, supra note 25, at 24.
32 See SEUA, supra note 30.
35 There was a belief that although insurance companies preferred singular federal supervision before Paul v. Virginia, they changed the position after the SEUA case based on a fear of federal antitrust regulation, which could prevent cooperation for collection and dissemination of risk information. See Henry N. Butler & Larry E. Ribstein (hereinafter referred to as “Butler & Ribstein”), A Jurisdictional Competition Approach to Reforming Insurance Regulation: Research Symposium on Insurance Markets and Regulation (April 14, 2008), at 5.
insurance business, the collection of taxes, and the insurance exemption from the federal antitrust statutes, under certain conditions. The key substantive provision of McCarran-Ferguson Act is as follows:

“(a) State regulation: The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business. (b) Federal regulation: No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: Provided, That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended [15 U.S.C. 41 et seq.], shall be applicable to the business of insurance to the extent that such business is not regulated by State Law.”

There were three different interests to balance in enacting the McCarran-Ferguson Act. The stock fire companies were faced with criminal charges from SEUA case and federal antitrust laws prohibiting all collective ratemaking. The fire insurers also wanted to escape state regulation and taxation through the Commerce Clause. The Roosevelt administration wanted to allow collective rates under state law but still apply federal antitrust law against boycotts, coercion, and intimidation without state supervision. The states and the NAIC were willing to continue the state’s day-to-day regulation and taxation

37 The amount of tax on the insurance industry by the states was $123 million in 1943. See supra note 30, at 590.

38 See 370 U.S. 451 (1962), at 455-456. Justice Douglas mentioned senator McCarran’s statement during the senate debate: “... we give to the states no more power than they previously had, and we take none from them.”

39 McCarran-Ferguson Act, 15 USC Sec. 1012.

40 See Raymond supra note 24, at 16. Fire insurance companies intended to shift regulation from the states to the federal government.
without restrictions such as the Commerce Clause. The NAIC\textsuperscript{41} drafted the Act, which was enacted on March 9, 1945.\textsuperscript{42}

D. The states try to reform regulation with the NAIC

After 1981, the NAIC developed its function as a forum for unity and for the introduction of new regulation and model acts. The NAIC began to pursue the uniformity of rules and supervisory tools. States started to adopt new regulation by adopting The NAIC model acts.\textsuperscript{43} However, in the late 1980s and 1990s, several insurers failed, which brought on doubt concerning the state guarantee funds and brought renewed interest in federal regulation. The introduction of the Financial Modernization Act of 1999, also called Gramm-Leach-Bliley Act, began the competition between state-regulated insurers and federally chartered banking and investment companies.\textsuperscript{44} The Gram-Leach-Bliley Act created a comprehensive structure to permit affiliations among banks, securities firms,

\textsuperscript{41} The NAIC could strongly influence legislative activities because it had a lot of expertise in dealing with the legislative process. The NAIC also had strong support from the insurance companies. Congress also agreed to restore the states' power to what the states had prior to SEUA.

\textsuperscript{42} There was no serious thought to establish a federal insurance authority due to the lack of federal expertise or preparation with which to replace states' supervision. See Raymond, supra note 24, at 18.


\textsuperscript{44} It is contended that the regulators in the U.S. are swayed by political, economic interests such as revenues from premiums and corporate income taxation rather than by the need to protect policyholders and encourage financial stability of the market. See Kwon, W. Jean, Uniformity and Efficiency in Insurance Regulation: Consolidation and Outsourcing of Regulatory Activities at the State Level (March 2007), at 11, available at SSRN: http://ssrn.com/abstract=985577.
and insurers and demanded that states reform to permit insurance companies to compete more effectively in the newly integrated financial service market. 45

II. Antitrust exemption of insurance under McCarran-Ferguson Act

A. Historical background and requirements of exemption

The McCarran-Fergusson Act (MFA) limitedly and expressly exempts the insurance business from federal antitrust law. In brief, the MFA provides exemptions, if the challenged conduct is:

- regulated by state law;
- part of the "business of insurance"; and
- not categorized as an agreement to or act of boycotting, coercion or intimidation.

The requirements for applying the antitrust exemption are different from the state action doctrine that requires clear articulation and active supervision. 46

From early on, "the issuing of a policy of insurance" was not considered "a transaction of commerce" within the meaning of the Privileges and Immunities Clause or Commerce Clause of the Constitution of the United States. 47 Thus, before the decision in SEUA, courts assumed that the states reserved the right to regulate insurance companies. Overtime, however, the commercial transactions were changing and many were subjected

45 Supra note 13.


47 The court confirmed it. See supra note 19.
to federal regulation; for example, transmission of electrical impulse over a wire between states, lottery tickets, and transport of whiskey across state lines in private automobile were considered interstate commerce. Finally, the U.S. Supreme Court changed its position on the nature of insurance transactions and decided that an insurance company that conducted a substantial part of its business across state lines was engaged in interstate commerce and thereby subject to federal antitrust laws.

As it is noted, the Supreme Court decided that insurance was within the reach of federal regulation under the Commerce Clause and therefore subject to antitrust laws. However, there were several challenges to expand antitrust application to the insurance industry:

- the fear of losing the state power to regulate and tax the insurance industry;
- a preemption issue that was debated between the state regulation and the federal authority to apply the Sherman Act; and
- the concern of losing “efficiency-enhancing joint insurer activities”.

Thus, Congress enacted the MFA to overturn the effect of SEUA, so that the federal antitrust laws shall not apply if all three requirements are satisfied. Therefore if the challenged conduct is not part of the insurance business, is not regulated by State law, or

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48 *Pensacola Tel. Co. v. Western Union Tel. Co.*, 96 U.S. 1 (1877).

49 *Lottery Case*, 188 U.S. 321 (1903).


51 *See supra* note 30.

52 *See E. Thomas Sullivan Jeffrey L. Harrison, Understanding Antitrust and its Economic Implications* (1988), at 57

53 *See below B. Limited Federal Exemption under McCarran-Ferguson Act for Insurance*, at 7.
is within an agreement to or act of boycott, coercion, or intimidation, the conduct will not be immunized even though the act is done by insurance companies.\textsuperscript{54}

B. Limited federal exemption for insurance under the McCarran-Ferguson Act

1. Conduct under regulation by state law

The challenged business activities must be regulated by state law to be exempted from the federal antitrust laws, but the exact scope and meaning of "regulated by state law" have been left to the interpretation of courts.\textsuperscript{55} The requirement of regulation by state law that makes the challenged acts get exemption from federal antitrust law under the MFA may be satisfied if a general prohibitory regulatory standard is provided even when the regulatory scheme is never enforced and sometimes when the regulatory scheme is not described to directly apply to the insurance industry from some of lower court's decisions.\textsuperscript{56}

2. Conduct to constitute business of insurance


\textsuperscript{55} See United States Government Accountability Office [hereinafter referred to as "GAO"], Legal Principles Defining the Scope of the Federal Antitrust Exemption for Insurance [hereinafter referred to as "Exemption"], B-304474 (March 4, 2005), at 11.

\textsuperscript{56} See e.g., Federal Trade Commission v. National Casualty Company, 357 U.S. 560 (1958), See also Bauer, supra note 52, at 132.
The conduct must be qualified as the business of insurance\(^{57}\) for exemption by McCarran-Ferguson Act. The Supreme Court has noted that the exemption is for the "business of insurance," not the "business of insurers," and for the conduct of, not the status of the defendant.\(^{58}\) The three key components of the business of insurance are considered:\(^{59}\)

- transferring or spreading the risks of policyholders;
- an integral part of the policy relationship between an insured and its insurer; and
- business concerning entities within the insurance industry itself.\(^{60}\)

However, the Court warned that "[n]one of these criteria is necessarily determinative in itself."\(^{61}\)

The challenged activity must meet the standard that the insurer is engaging in an underwriting or risk-spreading role.\(^{62}\) When the insurer does not assume a significant underwriting or investment risk, the insurance products are not within the business of insurance. For instance, search and examination conduct of title insurers is not within the business of insurance because search and examination services are often prepared by

\(^{57}\) The business of insurance is distinguished from the business of the insurance companies, therefore the business insurance requirement is a conduct-oriented rather than an entity-oriented analysis. See Julian O. von Kalinowski, *Antitrust Laws and Trade Regulation*, Second Edition (2005), § 53.05 Statutory Immunity for Marine Insurance.


\(^{61}\) *Id.*

\(^{62}\) *See supra* note 52, at 124.
persons other than title insurance companies.\textsuperscript{63} The insurance products which are mainly investment vehicles or financial guarantees are not qualified exemptions because it is not considered the unique or original business of insurer: municipal and corporate bond insurance, variable life insurance, variable annuity products, and guaranteed investment contracts that are offered in competition with bank, mutual funds, especially due to competition with similar products sold by other financial institutions.\textsuperscript{64} The relevant factors that allow the product to be within the exemption are whether the insurance product and annuity are related to insurance risk, shifting investment risk from the contractor to the insurance company, or whether they are functionally similar to the non-insurance products, i.e. general financial products. Where a life insurance policy or annuity has both insurance and investment-like characteristics, the exemption may apply only to the former features.\textsuperscript{65}

The core parts of the business of insurance are the relationship between the insurer and the insured; the type of policy that could be issued; the policy’s reliability, interpretation, and enforcement, including the selling and advertising of policies as well as the licensing of companies.\textsuperscript{66} Reinsurance and retrocessional insurance are included in the business of insurance because the practices are based on an offering of primary insurance.\textsuperscript{67}

\textsuperscript{63} See \textit{Ticor Title Ins. Co. v. FTC}, 998 F.2d 1129, 1133-34 (3\textsuperscript{rd} Cir. 1993). The business of insurance is somehow unique to insurance company and originated from the work of insurer.

\textsuperscript{64} See \textit{ABA SECTION OF ANTITRUST LAW} (hereinafter referred to as "ABA Antitrust"), \textit{The Insurance Antitrust Handbook} 2d. Ed. (2006), at 8.

\textsuperscript{65} See \textit{Otto v. Variable Annuity Life Ins. Co.}, 814 F.2d 1127, 1131-32 (7\textsuperscript{th} Cir. 1986).


\textsuperscript{67} See \textit{supra} note 56.
The challenged conduct must be limited to activities within the insurance industry in order to fall under the exemption. Many insurers' practices may be outside the scope of the business of insurance when the services are not provided pursuant to an insurance contract; the provision of inspection, loss prevention, and claims processing are not within the area of business of insurance, when selling those services separately from an insurance policy. Examples of activities outside the exemption include third-party claims, administration services, real-estate escrow services, and financing of premiums that are provided by insurers along with the sale of a policy.

The McCarran-Ferguson Act did not provide for a total exemption of the insurance business from any application of antitrust law, but the Act puts the insurance industry under state authority for taxing and supervising. Thus the insurance industry is regulated by state antitrust law. Insurers normally have been exempted from antitrust or competition laws in the U.S. through the McCarran-Ferguson Act, which insulates insurers from most of federal antitrust laws. In addition, some states enacted similar statutes to insulate the insurance against state competition law.

III. Overview of challenging issues

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68 In other words, those challenged services and activities can be within the business of insurance if they are selling upon the insurance contract.

69 See United States v. Title Ins. Rating Bureau, 700 F.2d 1247, 1251-52 (9th Cir. 1983).

A. Regulatory structure required to reform

1. State's out-of-date regulation in the U.S.

States have regulated the insurance industry for more than 130 years, but the strong need to reform the regulatory system has arisen because current state-based regulation system is lack of globalize, efficiency and globalization compared to other financial sectors. The current state-based system is also criticized by the the costly regulatory compliance requirements. After the Gramm-Leach-Bliley Act was enacted, the competition between banks and insurers has increased to difficult levels because banks are expanding to sell insurance products such as annuities and debt cancellation or suspension products. Insurers complain of their severe competitive disadvantage compared to other financial services industries due to the cumbersome regulatory system and much more lengthy processes for approval of new insurance products than for products in the rival industries.

2. Regulatory conflicts in Korea

71 In the early 1990s, a bill was introduced to repeal the limited antitrust exemption granted insurance companies in McCarran-Ferguson Act and to expand federal regulating power of insurance industry, but the bill was never reached the House floor. See Baird Webel, *Modernizing Insurance Regulation: Optional Federal Charter Legislation* (December 14, 2007), Congressional Research Service Report RL34286, at 1.

72 See Waterfiled, *supra* note 34, at 295-298. Debt cancellation products are similar to credit insurance, which protects the lender from risks of loan loss when the contractual contingency happens. The lender would charge a cost when the loan is made for reservation to use the coverage.

73 *Id.* at 298-299.
The Korean regulatory system has different standards and structure than the U.S. federal and state-based regulatory scheme; however, Korea also needs reforms to resolve the conflicts among regulatory authorities, the inefficiency of regulation and confusion in the markets, and the improper checks and balances in regulatory system.

B. Heavy burden of market access

1. Over fifty-one requirements for company licensing in the U.S.

All insurers, including producers, are required to get licenses to do insurance business, such as selling products and services in a certain state. State-based regulation necessarily requires meeting specific standards, a process on which insurers spend a lot of time and money. For the producers, such as agents and brokers, uniform procedure is prepared and available, although not all states have adopted these procedures; for the insurers, however, uniform procedures do not exist.

2. Restriction on issuing new licenses in Korea

Korea has one standard to access the market, but the requirements to meet this standard differ for domestic versus foreign insurers and for individuals versus corporations. However, even if an applicant satisfies the statutory requirements, the insurance license may not currently be issued because of an "economic needs test" which is decided by government to maintain market stability by blocking new market
participants. It is an anticompetitive method to give the profits to existing insurers even though it may diminish the welfare of consumers and innovation of insurers.

The problem with Korean licensing is the policy to withhold licenses. The regulator basically has not allowed the issuance of any new licenses since 2004. As an exception, allowance is made for mono-line insurance companies such as mortgage insurance and reinsurance carriers but not for comprehensive life or non-life insurance companies. The regulator contends that control of the market participants is necessary to avoid cruel market competition and insolvent insurers. The government also seems to think that the insurance market is already mature and can not grow any more.

C. Debate for removing or limiting the insurance antitrust exemption

1. Overbroad exemptions to insurance in the U.S.

An industry-specific exemption statute is not usual in the area of antitrust law and the debate is getting hot that this exception is good for consumer welfare. Consumer agencies, the State Attorney General, and the American Bar Association (ABA) argue for either a total repeal or a more limited exemption from the McCarran-Ferguson Act because the current immunity gives too broad an exemption and is not necessary to achieve pro-competitive benefits in the insurance industry. Opponents of the exemption argue that an exemption should be allowed only when a compelling situation demonstrates the impracticability of competition or when an obviously dominant social

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purpose exists, and any exemptions should be applied in the least anticompetitive way to achieve the regulatory aim. The current McCarran exemption is an obstacle to increased efficiency of output and lower prices.\textsuperscript{75}

2. Conflicting administrative guidance in Korea

The competitive process normally enhances consumer welfare by increasing efficiency; on the other hand, the regulation can be proper to deal with market failures or to advance social welfare. Sometimes the differing goals between competition authorities and regulatory agencies creates conflicts: where the insurer follows the administrative guidance, but those actions result in a violation of antitrust laws. The debates are focused on whether administrative guidance that lacks statutory grounds can lead to a legitimately exemptible activity. The situation also leads to debate whether the competition authority or the financial regulator should be the antitrust policy regulator, in terms of expertise. There are limited numbers of insurance antitrust cases to reference when resolving problems, and there is no specific statutory provision for an insurance exemption. The current antitrust issue is that the conflicting sources of administrative enforcement in the Korean insurance industry must be reformed.

\textsuperscript{75} \textit{Id.} at 143-144.
Chapter 3: Symbiotic Regulatory Competition in Federation and State

I. Need and Principles to regulate the insurance industry

A. Insurance is for transferring risk, not for profit

In real life, we cannot live without risks like danger, hazards, and possibilities of loss or injury.76 We can ignore or deny the risks, or we can take steps to minimize the risks without abandoning a normal life. The basic goal of insurance is to address and compensate for the potential economic loss. Insurance deals primarily with compensation of designated beneficiaries when property, health, or life is in danger, lost, or hurt. Insurers provide this compensation by “risk pooling” through putting people or risk into homogeneous groups and charging a premium, thus minimizing the risk to be able to give compensation when loss occurs.77

“Insurance is a contract whereby one undertakes to indemnify another against loss, damage, or liability arising from a contingent or unknown event.”78 The major difference between insurance and a general contract is that with insurance, one party assumes the risk or liability of another for some consideration. The insured pay a fixed premium to cover the loss for the time period, and the insurer manages the process, including costs

76 Insurance industries are part of a very aged and significant global infrastructure beginning over 5,000 years ago with the old Babylonians, Phoenicians, and Greeks. See Insurance Regulation and Competition for the 21st Century: Hearings before the Committee on Financial Services U.S. House of Representatives, 100th Cong. 136 (June 4, 11, 18, 2002).


and benefits, and predicts the number and size of losses that are likely to occur during that period.79

B. Why regulate the insurance industry?80

3. Ensure consumer protection

The insurance system is needed to provide insurance for the benefit of the insured. Insurers provide insurance products and the insurance consumers purchase policies. The main differences between insurance products and other financial products are the length of coverage and delivery of product satisfaction and value. A savings type of product like an installment deposit also delivers value in the future, but an insurance product extends for a longer period and loss must occur before getting compensation or indemnification. The depositor can get a return on deposited funds after a certain period has passed, but the insured cannot receive the promised insurance payment, which is better than receiving proceeds because the proceeds is given after the accident is happened or risk is realized,82 without the designated loss or event. In addition, at the time of the purchase, the insurance consumer cannot estimate what a proper premium amount or what the proper terms and conditions of the policy should be, so experts such

80 See GAO, Financial Regulation, GAO-09-216, at 4.
81 The term “insurance consumer” includes the policy buyer and the insured; the insured is the person who has the rightful claim to receive the insurance money.
82 Actually the accident and risk are related social costs and the individual is also unhappy even though economically reimbursed.
as a government regulator must review the price and the contents of the insurance product. The regulator’s product-approval process is also needed to assure equitable rating classification and to boost the marketing process by sharing information about the insurance product. Therefore, insurance regulation can inform about and protect consumers from unfair insurance contracts.\footnote{One basis of consumer protection is a presumed information asymmetry between consumers and insurers. It is difficult for an individual consumer to evaluate policies meaningfully. Insurance policies are adhesion-type contracts, which hinder consumers from being able to bargain for favorable terms and conditions. As a result, insurance companies have a chance to overcharge for distant and unlikely events. \textit{See Butler & Ribstein supra} note 35, at 4.} Through proper regulation, the government should provide an environment that encourages insurers to supply high quality and fairly priced products. Furthermore, because insurance products can potentially cause consumer confusion and dissatisfaction regarding policy terms, experts should review the claim’s price and validity.\footnote{\textit{See Testimony of the National Association of Insurance Commissioners, supra} note 5, at 112.}

4. Secure insurance institutions

The insurer must gather and interpret the data necessary to fix premiums that enable the insurer to cover all costs, pay the proceeds on losses, and manage the business of insurance. If the insurer goes bankrupt and fails to pay the proceeds for the insured’s loss, it will be disastrous for the individual and for the social safety net. The potentially harmful results form one of the reasons to regulate insurance companies: to ensure the safety and soundness of insurers themselves so the insurers can promise future payments to the insured. Because insurance is a “future deliverable product,” the regulators must
watch out for the insurer’s failures and abuses.\textsuperscript{85} Supervision is needed to avoid overreaching by insurers and to assure the solvency of insurers, especially since insurance is a widely recognized business that directly affects the public welfare.

5. Oversee the integrity and fairness of markets

Another purpose of insurance is providing security for individuals and society; to effectuate this security a government guarantee can provide general confidence of the insurance “safety net” and can prevent market failure.\textsuperscript{86} No insurance consumer will buy an insurance policy without confidence that the future proceeds can be paid. Government regulations of the minimum capital, asset portfolio, and minimum solvency margin are, thus, common understanding. The public and social character of insurance can also be a basis for regulation.\textsuperscript{87} There may be an objective to avoid social expenses by encouraging and maintaining the prudence of insurance companies. Regulation is also needful and beneficial economically because its benefits exceeds its direct and indirect costs by preventing market failure, which private and social expenses are much higher. The

\textsuperscript{85} Insurers have an incentive to charge low premiums to draw in many contracts in the short run, but this practice may increase the probability of default when the claims come due. Thus, to attract customers the rate must not be too high, but to allow for coverage and to secure the safety and soundness of the insurer, the rate must not too low. See Henry N. Butler & Larry E. Ribstein (hereinafter referred to as “Butler & Ribstein”), \textit{A Jurisdictional Competition Approach to Reforming Insurance Regulation: Research Symposium on Insurance Markets and Regulation} (April 14, 2008), at 4-5.

\textsuperscript{86} The guarantee funds protect consumers by giving proper payments when insurance companies default. These funds, however, may create moral hazards by decreasing the insurance industry’s motivation to protect against default.

\textsuperscript{87} However, there is no historical or real basis that the insurance industry has public or social characteristics, although those characteristics are introduced to strengthen the basis for regulation in comparison to any other regulatory industry. In other words, it is contended that the insurance has the responsibility for the public and society like governmental function, thus the insurance industry must be regulated heavily. See Ho Yul Chung, \textit{Korean Insurance Market and Competition Law}, KIDI Research Paper 2008-2, n.27 at 31 (Korean version).
prudence regulation of the insurance market and of insurance companies enables insurance proceeds to be met in the future and avoids spending public funds on the insolvency of the insurance industry or on the bankruptcy of an individual insurance company.\textsuperscript{89}

C. How to regulate the insurance industry?

Regulation can be classified several ways and varies from light regulation to heavy regulation. Government regulation of policies and administration can be classified in three ways: legislative, judicial and executive.\textsuperscript{90} The legislative body enacts laws to establish the legal framework. The judiciary resolves disputes regarding regulatory issues between parties of interest who are in insurance agreements. The executive regulators can set standards to let prudent insurers start their businesses and can control the market practices to secure fair competition in the market. The executive regulators also investigate the business and propose laws to enhance efficiency and the general welfare, but the executive regulators have implied limitations on their powers, discretion, and ability to enforce.\textsuperscript{91}

\textsuperscript{88} The prudence regulation is pursuing for maintaining the minimum financial requirement like minimum capital, solvency margin and asset portfolio, etc to give insurance payment at any time.

\textsuperscript{89} See Martin F. Grace and Robert W. Klein, Insurance Regulation: The Need for Policy Reform, CENTER FOR RISK MANAGEMENT & INSURANCE RESEARCH GEORGIA STATE UNIVERSITY (May. 2008), at 11.

\textsuperscript{90} Kwon, supra note 44, at 2.

Interested parties are also intensely debating whether more regulation can solve the financial problems or whether heavy regulation will just reduce market discipline and increase the moral hazards. For example, approval regulations of insurance policies are different from state to state. Most states require prior approval because the complexity and technical difficulties involved in insurance contracts are hard for average consumers to understand. At least seven different levels of regulatory restrictions exist regarding policy forms in the several states:

- "strict prior approval" means that without affirmative approval the policy cannot be used;
- "prior approval" means that unless specifically disapproved, the form is "deemed" approved after passing a certain waiting period;
- "file and use" means the policy must be filed on or before the planned effective date;
- "use and file" means that the policy may be used before filing, but must be filed after a certain number of days;
- "form filing only" means that the policy must be filed without a specific time period; and
- "no form filing is required" means there is no regulatory restriction.

92 See HOW SHOULD THE FEDERAL GOVERNMENT OVERSEE INSURANCE?: HEARING BEFORE THE SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES OF THE COMMITTEE ON FINANCIAL SERVICES U.S. HOUSE OF REPRESENTATIVES (hereinafter referred to as "Federal Oversee"), 111th Cong. 3 (May 14, 2009)

D. Suggestion of five principles for reasonable regulation

The principles of reasonable regulation in the insurance market can be described several ways. However, there are 5 basic principles that regulations must follow:

1. ensuring consumer and investor protection,
2. securing that the insurance institution is safe and sound, and
3. overseeing the integrity and fairness of markets.

These principles parallel the reasons for insurance regulation. The principles naturally flow from the needs and satisfaction fulfilled by regulation. The other principles can be extracted from the regulatory system requirements:

4. monitoring the stability of the financial system, and
5. enhancing efficient and effective supervision.

The first three of the five basic principles are reasoned and explained as follows:

To maximize profits, some insurers and producers may sell unsuitable products or unfairly priced products as a deceptive market practice. To avoid this situation, the regulator must give sufficient information for consumers to make appropriate decisions and for preventing fraud and abuse from insurers or distributors. Because insurers sometimes take excessive risks that can have negative impact on consumers, investors, and taxpayers, regulatory authorities must review insurers’ risk-taking activities to enhance the safety and soundness of the insurers. Regulators prepare rules so they can

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94 See supra note 77, at 49-63.

95 The investors in insurance companies also must be legally protected and must be allowed access to consistent as well as useful information such as financial disclosures.

96 See above B. Why regulate the insurance industry?
monitor markets and their participants to prevent fraud and manipulation and to promote efficient market activity since some market participants could try to manipulate the markets to gain unfair profits.

The last two of the five basic principles, monitoring the stability of the financial system and enhancing efficient and effective supervision, are added for following reasons: The current financial market is affected by the banking, securities, insurance, and other financial sectors or industries; therefore, even perfectly functional regulation of one industry alone may not guarantee or maintain a prudent and efficient market. Thus the regulatory authorities must cooperate, enhancing the ability to monitor the financial market and spread the risks adequately. For instance, in the U.S. financial crisis, which was mainly caused by the default of subprime mortgage loans, many market participants played roles, including banks, nonbanking lenders, mortgage brokers, securities underwriters, investors, rating agencies, and credit default swap sellers such as American International Group (AIG). In the turmoil, any individual financial sector, like the insurance industry, could not survive intact; and any regulator alone, such as a state insurance department, could not prevent the bankruptcy or risk of insolvency because the risk was a combined risk pooled from multiple financial sectors.

The efficiency of regulatory authorities is important because it can increase consumers' and insurers' benefit by decreasing operational costs and because it can increase insurers' competitiveness by allowing them to concentrate on the core business instead of wasting time and efforts on the hassles of unnecessary requirements. Regulatory competition and comparison are also helpful to improve the competitive
power in regulatory authorities, to increase internal innovation, and to encourage positive reforms of supervisory methods.

II. Establishing federal regulations for the insurance industry

A. State-based regulatory system in the U.S.

1. Regulation of the insurance industry by state insurance departments

For the past approximately 150 years, the states have been regulating the insurance industry in contrast to other financial services firms, as defined in the 1868 decision of the U.S. Supreme Court, *Paul* case. There are at least fifty-one requirements to satisfy before issuing licenses in the insurance industry in the U.S. Each state has an insurance regulator, the State Insurance Department, which typically has broad, legislatively delegated powers to implement state insurance laws, proclaims

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97 See Baird Webel, *Insurance Regulation: Background and Issues*, CRS Issue Brief for Congress (Sep. 29, 2003), at CRS-1.


99 The New Hampshire Board of Insurance was first established in 1851.

100 The New York State has the longest history of insurance regulation. The New York Superintendent of Insurance position was first created in 1859 (L. 1859, c. 366), and the first comprehensive insurance law was enacted in New York in 1892 (L. 1892, c. 690). See John Dembeck, *Insurance Regulation In a Nutshell*, Debevoise & Plimpton LLP (2008).
rules and regulations, and holds hearings to determine resolutions to disputed issues.\textsuperscript{101} The head of the department is normally named commissioner or director of insurance, and the commissioner is appointed or elected.\textsuperscript{102} The state government can set different standards for licensing, although the NAIC encourages uniformity in state insurance regulators. The diverse and complex U.S. insurance market is affected by this regulation in a lot of ways.\textsuperscript{103}

Each State Department has similar but different goals that include fair pricing of insurance products, securing insurer solvency, preventing unfair practices by insurers, ensuring availability of insurance coverage, and protecting consumer interests. State insurance departments dealt with approximately 3.7 million consumer complaints and inquests about the content of policies and the treatment of customers by insurers or agents. Many of those issues are resolved successfully with little or no cost to the consumers.\textsuperscript{104} The states regulate the licenses, monitor solvency margins and internal business operation of the insurer, gather periodic financial statements, approve the rate and policy forms, mediate the consumer complaints, research market conduct, and analyze all information helpful to improving regulation; however, regulatory statutes, rules, and standards widely vary from state to state.\textsuperscript{105}

\textsuperscript{101} See Randall, \textit{supra} note 22, at 629.

\textsuperscript{102} Elected commissioners are from California, Florida, Louisiana, North Carolina, and Washington, etc.

\textsuperscript{103} There are a lot of federal or state regulations that affect the insurance industry, some examples include the Americans with the Fair Labor Standards Act (29 USC ss201 et seq), several tax laws, securities laws, and consumer protection laws.

\textsuperscript{104} See \textit{supra} note 80, at 112.

\textsuperscript{105} See \textit{supra} note 92, at CRS-3.
2. The National Association of Insurance Commissioners (NAIC)

The NAIC is the voluntary association of the heads of insurance regulatory authorities and organizations; the NAIC supports state insurance regulators and serves the public interest.\(^{106}\) It also promotes the fundamental insurance regulatory goals of its members.\(^{107}\) The NAIC does not have the authority to issue licenses, but it may prepare standard regulations and processes and make getting a license easier by standardizing the registration process. The NAIC also plays important quasi-governmental roles. It began in 1971 to promote uniformity and efficiency of insurance regulation. The NAIC was organized as a Delaware corporation and is headquartered in Kansas City, Missouri; the NAIC had 422 authorized personnel as of 2003 and a budget of $74 million as of 2009 and has additional offices in New York City and Washington D.C.\(^ {108}\) The NAIC is funded by assessing fees for its services and publications, including database fees, fees to rate securities for admitting non-U.S. insurers into the U.S. market, education fees, sales of its publications and subscriptions (e.g., guidelines, reports, model

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\(^{106}\) See AMERICAN INSURANCE ASSOCIATION, AMERICAN RE-INSURANCE COMPANY, ET AL., v. JOHN GARAMENDI, IN HIS CAPACITY AS COMMISSIONER OF INSURANCE FOR THE STATE OF CALIFORNIA, BRIEF OF THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS AS AMICUS CURIAE IN SUPPORT OF RESPONDENT, No. 02-722, In the Supreme Court of the United States, at 1.


laws and regulations), as well as fees for filing annual financial statements for analysis.\textsuperscript{109}

The NAIC provides the following services:\textsuperscript{110}

- national databases enabling states to monitor insurers and their agents;
- the ratings of non-U.S. insurance companies;
- the periodic consultation and evaluation of state insurance departments;
- the drafting of model rules and standards that can be adopted by the states;
- the review of insurers’ investments
- the education of state regulator staff;
- the provision of statistical reports and technical financial analysis; and
- helping U.S. officials negotiate international trade agreement regarding insurance.

The NAIC has made efforts to reform insurance regulation, for instance, by establishing an online system for electronic rates and form filing (SERFF).\textsuperscript{111}

3. Federal regulation of the insurance industry

From the beginning of the insurance businesses, federal agencies basically did not interfere with the insurance sectors, mainly due to the \textit{Paul}\textsuperscript{112} case and the McCarran-Ferguson Act. Although Congress has the regulatory power under the Commerce Clause of the Constitutional Law, Congress delegated its power to states and did not concern

\textsuperscript{109} See \textit{NATIONAL ASSOCIATION of INSURANCE COMMISSIONERS 2008 ANNUAL REPORT}, at 13, About the NAIC, NAIC Annual Report, \textit{available at} http://www.naic.org/index_about.htm.

\textsuperscript{110} See Randall, \textit{supra} note 22, at 634-639.

\textsuperscript{111} See SERF Homepage, www.serff.org.

\textsuperscript{112} \textit{Supra} note 21.
itself with insurance issues and risks. However, some specific areas of the insurance industry are regulated by federal laws and regulations. After enacting the Employee Retirement Income Security Act (ERISA) in 1974,\textsuperscript{113} which preempted state laws regarding health benefit plans provided by employers, the federal regulation governs much of health insurance. Also, the Federal Trade Commission can still investigate violations of federal antitrust law.\textsuperscript{114} Insurers' opinions are divided regarding the establishment of a federal agency to regulate the insurance industry; larger insurers tend to favor federal regulation, but smaller insurers favor the current state-based regulation. Life insurance companies particularly favor federal regulation to facilitate competition with banks and securities companies; they advocate a federal charter more than the property and casualty insurance industry does.\textsuperscript{115}

The responsibility for current insurance regulation rests on the individual states; however, both Congress and Federal courts have affected the insurance sphere by enacting special statutes and through the interpretation of the McCarran exemption. Congress governs the insurance industry by enacting special statutes, such as the Terrorism Risk Insurance Program Reauthorization Act of 2007 and the bill in the Senate called the Nonadmitted and Reinsurance Reform Act.\textsuperscript{116} The Terrorism Risk Insurance

\textsuperscript{113} P.L. 93-406, 88 Stat. 829.

\textsuperscript{114} However, Congress decreased the authority of Federal Trade Commission (FTC) to investigate the insurance industry so that federal government has only narrow oversight of the insurance industry. See The Federal Trade Commission Improvement Act of 1980. P.L. 96-252, 94 Stat. 374.

\textsuperscript{115} See Baird Webel, supra note 97, at 2.

\textsuperscript{116} This bill, H.R. 2571, has been passed in the House. The bill's purpose is to enhance efficiency in the surplus lines and reinsurance marketplaces. The bill forbids any state other than the home state of an insured to require a premium tax payment for nonadmitted insurance, and the bill is being reviewed in the Senate. Vote and debate may also be held on a companion bill in the Senate. See H.R. 2571: Nonadmitted and Reinsurance Reform Act of 2009, Govtrack.US, a civic project to track Congress, available at http://www.govtrack.us/congress/bill.xpd?bill=h111-2571 (last visited on February 12, 2010). Congress
Program Reauthorization Act of 2007 went into effect on December 26, 2007; the Act extends the Terrorism Risk Insurance Act through December 31, 2014 to continue construction at the terrorist attack.\textsuperscript{117} Through the act, the law extends the temporary federal program requiring a transparent system of shared public and private compensation to include the situation where the insured’s losses result from acts of terrorism; thus, the insurer has to underwrite and give claims unless the coverage is excluded or unless a cap is reached.\textsuperscript{118} Other examples of federal regulation include the Employee Retirement Income Security Act of 1974 (ERISA)\textsuperscript{119} and the Liability Risk Retention Act of 1986 (LRRA).\textsuperscript{120} The ERISA effectively federalized health insurance regulation by establishing minimum rules for pension plans in the private industry and by providing for extensive standards on the federal income tax regarding employee benefit plans;\textsuperscript{121} the LRRA preempted the regulation of non-domiciliary states on certain types of property and casualty insurance.\textsuperscript{122} The Gramm-Leach-Bliley Act of 1999 (GLBA)\textsuperscript{123} attempts to

plans that each state will adopt nationwide uniform standards, forms, and procedures. It also offers the reporting, payment, collection, and allocation of premium taxes for nonadmitted insurance. It would allow an insured’s home state to demand surplus lines brokers and certain insureds to report annual tax allocation of the nonadmitted insurance premiums assignable to properties or risks located in each state. See \textit{H.R. 2571, The Nonadmitted and Reinsurance Reform Act of 2009}, Washingtonwatchdog.com, available at http://www.washingtonwatch.com/bills/show/111_HR_2571.html.

\textsuperscript{117} \textit{See} Federal Oversee, \textit{supra} note 92, at 1.


\textsuperscript{119} P.L. 93-406, 88 Stat.829.

\textsuperscript{120} 15 U.S.C. § 3901 et seq.

\textsuperscript{121} \textit{See} above II. A. 3. Federal regulation of the insurance industry, at 37.

\textsuperscript{122} Under the law, risk retention groups (RRGs) are formed when a liability insurance company in at least one state, which is considered its domiciled state, is only required to file its plan for starting operations in other states. \textit{See American Equestrian Alliance, A Guide to the 1986 Liability Risk Retention Act}, available at http://www.americanequestrian.com/legal/rrg1986.htm.
increase competition among insurers, securities firms, and banks by removing legal barriers by leveling the playing field in regulation. The Act caused significant federalization of the insurance industry, removing inefficiencies and over-regulations, especially the state’s regulations against rate and policy form.  

An example of congressional interference was that Congress tried to establish the National Association of Registered Agents and Brokers (hereinafter referred to as “NARAB”). Although many states had made considerable progress in streamlining their producer licensing systems, NARAB urged and established minimum licensing reciprocity principles allowing an insurance agent or insurance broker licensed in one state to automatically meet the requirements as an agent or broker in any other state. The state was also required, however, to pay state nonresident licensing fees and meet the NARAB standard for membership. The NARAB provision was adopted according to the Gramm-Leach-Bliley Act of 1999 to resolve the problem that every state demanded a different standard for doing business from the agents and brokers. If a number of states did not reach a certain level of licensing reciprocity, Congress would have created NARAB, but enough reciprocity was provided to avoid the creation of NARAB. The reciprocity agreements became law in 2001 when twenty-nine states signed onto the

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124 See Federal Oversee, (Statement of Baird Webel, Congressional Research Service [hereinafter “CRS”]), supra note 92, at 144-145.

125 NARAB was planned to facilitate the issuance of nonresident licenses in additional states by functioning as a private, nonprofit entity managed by a board composed of state insurance regulators and marketplace representatives. State regulators continue to supervise and discipline producers and to enforce state consumer protection laws. Membership in NARAB would be voluntary and would not affect the rights of a nonmember producer under any individual state license. The bill established membership criteria, which would include standards for personal qualifications, education, training and experience. See Arthur D. Poster, Uniform License Bill For Agents Introduced In House, P&C National Underwriter (March 14, 2008), available at http://www.property-casualty.com/News/2008/3/Pages/Uniform-License-Bill-For-Agents-Introduced-In-House.aspx.
reciprocity between their agents and brokers. Although forty-seven states or jurisdictions are in compliance with those provisions to date, four of the largest states have not yet implemented the provisions: California, Florida, New York, and Washington State. Some of the others states have removed the principles of uniformity and adopted different requirements.¹²⁶ NARAB was neither a part of nor had a duty to report to any Federal agency, it is good example of a Congressional effort to unify the standards and eliminate the hurdles of fifty different requirements that hinder efficiency.¹²⁷

The federal courts also affect the insurance business by limit the meaning and scope of phrases of the McCarran exemption such as “business of insurance.” However, judicial regulation is inherently limited to interpretation of existing laws, rules and regulations.

B. Arguments for establishing a federal regulator

There is criticism that the current financial crisis can be attributed to the current regulatory structure and the regulatory failures that led to the failure of financial guarantees for insurance companies and the AIG bailout.¹²⁸ The possible options for

¹²⁶ See H.R. 5840, THE INSURANCE INFORMATION ACT OF 2008: HEARING BEFORE THE SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES OF THE COMMITTEE ON FINANCIAL SERVICES U.S. HOUSE OF REPRESENTATIVES 110th Cong. 6 (June 10, 2008) (Statement of Mr. Scott).

¹²⁷ H.R. 2554 was introduced to support independent insurance agents and brokers. The bill, called CES TS, I,” would provide for streamlined nonresident-insurance, agent and broker licensing. The bill would protect state insurance regulation and consumer protection provisions, and it would require agents applying for NARAB membership to surrender to a criminal background check, which only seventeen states currently require to be producers. See Arthur D. Postal, NARAB II Bill Is Here, Life & Health National Underwriter (May 21, 2009), available at http://www.lifeandhealthinsurancenews.com/News/2009/5/Pages/NARAB-II-Is-Here.aspx.

¹²⁸ See Federal Overseer, supra note 92, at 145.
federal executive intervention and regulatory reform range from minimal interference to a virtual federal takeover.\textsuperscript{129}

1. Maintain state-based regulation

There are two possible options for insurance industry regulation: one option is keeping the current regulatory structure without any reform; the other option is creating a preemptive federal standard. The supporting argument for the former proposal is that it is time to concentrate on coping with financial crisis and not on introducing additional regulatory uncertainties for the insurance market, particularly because the state-regulated insurance industry has produced good performance and quality. The latter proposal aims to harmonize state laws and regulation among the separate state regulators.

2. Create a federal office with limited functions

Two proposals for creating a federal office are raised: (a) creating a federal office of insurance information, and (b) creating a systemic risk\textsuperscript{130} regulator. The absence of a direct federal regulator over insurance has created a lack of information and expertise on insurance issues within federal government. For example, the Office of Thrift

\textsuperscript{129} The section below is mostly referred by suprat note 124, at 147-154.

\textsuperscript{130} "Systemic risk" is the risk that a collapse by one market participant will affect the other participants due to the domino effect of financial markets. The risk can spread to the entire global or national system of finance, where the failure of a single institution can begin a cascade that could bring down the entire system. See David Van Knapp, A Handy Glossary for Today's Economic Crisis (March 24, 2009), available at http://seekingalpha.com/article/127611-a-handly-glossary-for-today-s-economic-crisis, see also U.S. Commodity Futures Trading Commission, CFTC Glossary, available at http://www.cftc.gov/educationcenter/glossary/glossary_s.html.
Supervision, which regulated AIG, had only one insurance expert as an employee, and the Treasury Department did not have an insurance expert at all. After the financial crisis, the importance of exact information and expertise has been recognized. Before the financial crisis happened, the federal government did not appreciate that the exposure of specific companies to mortgage-backed securities and to credit default swap markets increased uncertainties in insurance and in the financial market. The NAIC can be a major source of insurance information, and play a significant role for a federal office, especially if the federal office would be restricted to collecting public data.

The other proposal is to create a systemic risk regulator, to prevent systemic collapse and the spread of systemic harm to whole financial system. The concern about organizations “too big to fail” and “too interconnected to fail” is increased after the financial crisis, and additional proposals suggest that an office to oversee the entire financial system should be established. However, there are several gray areas in setting up systemic regulators, such as the definition and range of systemic risks and the affected institutions, method of oversight, level of power needed to preempt and overturn, and the relationship with a guarantee fund to mitigate the systemic risks. For example, the recent crisis was not caused by a bank run but was brought by the withdrawal of short term

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132 CRS informally asked the Treasury Department if it had insurance expert staff members, supra note 124, at 155.

133 One example is the Insurance Information Act of 2008 (H.R. 5840 in the 110th Congress), which proposed the established of the Federal Office of Insurance Information to which NAIC would provide the relevant data.

134 See Federal Oversee, supra note 124, at 156.
credit and the demand from other counterparties for collateral payments, as occurred in the first case, AIG. If an office for systemic risk regulation is actually set up, the office would require extensive debate and research to formulate clear and effective systemic risk regulation. The federal support given to failed financial institutions, like AIG, can also cause a lot of complaints from competitors because the government essentially gave the failed company a competitive advantage, undercutting the other companies’ prices.\textsuperscript{135} Such interference might encourage other financial institutions to merge or grow in size, so they might gain advantage for survival as a company that is “too big to fail,” which could make the future crisis even worse.\textsuperscript{136}

3. Completely reform the insurance regulatory structure

Complete federal involvement may take the shape of a dual charter system, like banking regulation, and would be a comprehensive take over. A federal insurance charter is usually proposed as an Optional Federal Charter (hereinafter referred to as “OFC”),\textsuperscript{137} a topic focused on in regards to market access issues with OFC. The structural reform can be divided into two models; a “unitary” regulator and a “twin peaks” regulator.\textsuperscript{138} A unitary model is a single regulator set up to supervise every financial firm from systemic stability to individual internal operation, solvency standard, and consumer protection. The merits of a unitary regulator include the ability to clearing up regulatory authority,

\textsuperscript{135} AIG could lower the costs and price of insurance products by using governmental support.

\textsuperscript{136} Id. at 157.

\textsuperscript{137} OFC is dealt with below, Chapter 4, II, C. Create a federal regulator to issue licenses, at 79.

\textsuperscript{138} See Federal Oversee, supra note 124, at 153.
binding accountability and responsibility of the regulator, reducing consumer’s confusion and complaints, and keeping insurers from regulation shopping. However, the weaknesses of a unitary regulator include a risk of regulatory failure and a weakening of checks and balances; thus, in case of a mistake in regulation, the whole financial system could be affected. Examples of complete insurance-regulation systems are found in the United Kingdom, Germany, Japan, and Korea.

A twin peaks model typically divides the regulatory authority into prudent-regulator and consumer-protective functions, with different structures for each function. The advantages are almost the same as those of the unitary model, but overlap between the twin peaks of regulatory authority could lead to conflict or it could minimize the regulatory mistakes. Australia and the Netherlands are examples of countries employing this structure.\(^{139}\)

C. Arguments for maintaining state-based regulation

State regulators contend that the states monitor insurance business activities with highly trained professionals to support the stability of insurance markets to ultimately issue sound policies and to pay claims on time. State insurance officials supervise the market conduct by reviewing business operations through market analysis, periodic examinations, and investigation based on specific consumer complaints.\(^{140}\)

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\(^{139}\) Id.

\(^{140}\) See Testimony of NAIC, supra note 5, at 116.
From the point of view of an insurance commissioner, a federal regulator would be a massive bureaucracy that would benefit some of large insurers in the insurance industry at the expense of consumers' interests and costs.\textsuperscript{141} One of the reasons for this view is that most insurance carriers are small, state-fit businesses that work in niche markets and supply personalized service. For example, only 296 insurance carriers out of more than 5,000 insurers in the U.S. have more than 500 employees.\textsuperscript{142}

D. Principles-based approach to creating federal regulation

1. Current suggestions to reform regulatory structure in the U.S.

   a. Treasury proposal to reform financial structure

   The Treasury "blueprint" was an attempt to establish "a more flexible, efficient and effective regulatory framework,"\textsuperscript{143} which could be described as the "twin peaks plus model." The Treasury intended to conclusively establish three functional regulators:

   - a "prudential financial regulator" to oversee solvency;
   - a "business conduct regulator" to protect consumer interests; and
   - a "market stability regulator" to monitor systemic risks.\textsuperscript{144}

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\textsuperscript{141} See supra note 80, at 10. However, his view about federal bureaucracy can be applied to current state bureaucracies as well.

\textsuperscript{142} Id. at 115. However, those big insurers, which are less than six percent of total insurers, accounted for more than 90 percent of total insurance revenue in the U.S.

\textsuperscript{143} THE DEPARTMENT OF THE TREASURY, THE DEPARTMENT OF THE TREASURY BLUEPRINT FOR A MODERNIZED FINANCIAL REGULATORY STRUCTURE (March 2008), at 204.
To reach its ultimate shape, the Treasury blueprint suggests establishing a Federal Office of Insurance to supervise federally chartered insurance carriers.

Treasury recommended creating a Federal Office of Insurance Oversight (hereinafter referred to as “OIO”) in the Treasury, which is established as a leading regulatory voice in international regulatory policy and to serve as an advisor to the federal government regarding policy matters as an intermediary. The Treasury also ultimately intended to reform financial structure and create an Office of National Insurance (ONI) which would be established in the Treasury for overseeing the federally chartered insurance industry. The Treasury, however, recommended creating an optional federal charter like the dual banking system, instead of replacing the current state-based regulation with primary federal regulation.

b. Federal Insurance Office Act

The U.S. House Financial Service Committee passed a bill in December 2009 (H.R. 2609), which was included in H.R.4173 as the Wall Street Reform and Consumer Protection Act. The bill creates a Federal Insurance Office (hereinafter referred to as “FIO”), which would be a national insurance information agency and would have some authority in the area of international insurance agreements. The bill describes that a

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144 Id. at 143-146.
145 Id. at 11.
146 Id. at 10.
supervisory or regulatory authority is not currently established over the insurance
business and the FIO is forbidden from preempting state insurance laws that manage rates,
premiums, underwriting, coverage requirements, antitrust laws, and sales practices. 148
Under the bill, however, insurers, excluding agents and brokers, would be under a
mandatory data collection. According to the bill, the FIO is created within the U.S.
Treasury Department to deal with providing knowledge and information to the federal
government and to represent the United States in multilateral insurance issues or when
entering into obligatory international agreements. The FIO has no authority to govern
systemic risk in the insurance industry, but the director would participate in the Financial
Services Oversight Council, the proposed interagency group in charge of overall financial
systemic risk. 149

FIO may or may not be created; however, the existing organizations and
authority’s ability to understand the insurance industry, handle risks, and know the
customer needs is insufficient. The current FIO’s operations are not equipped to confront
the information and manage the complex, global issues. Even the NAIC supports FIO in
building up uniform regulatory standards and supports federal involvement not only
nationally but also within state borders. The NAIC is also researching to establish a
National Insurance Supervisory Commission (NISC), which would be created to achieve
uniformity in the states and to sustain competition in a global economy by federal law. 150

148 Id.

that Include Insurance?, Wiley Rein LLP (Jan. 25, 2010), available at

150 Id.
c. Insurance Information Act of 2009

The Insurance Information Act of 2009 was introduced on May 21, 2009. This bill contains a plan to establish the Office of Insurance Information, which would focus on internal and international policy issues regarding all lines of insurance except health insurance, to help the Secretary of the Treasury, who is a major counselor to the President and Congress. The Office of Insurance information would be established within the Department of the Treasury, and would be led by a Director appointed by the Secretary. The Office of Insurance Information would do the following:

- collect, analyze, distribute data and insurance information, and then issue reports;
- coordinate and establish federal policy on international insurance issues;
- determine inconsistent policies, and serve as liaison between the federal and the states regulators regarding business-of-insurance matters;
- recommend and nominate Treasury representatives for the export promotion of insurance products and services; and
- give counsel to the Secretary on domestic and international insurance issues.

This bill does not consider establishing a general supervisory or regulatory authority over the business of insurance rather than building up the Office of Insurance Information as an advisory group to advise on international insurance policy and to consult on the issue of preemption of state insurance actions. 152


152 There was an attempt to establish the Office of Insurance under Insurance Information Act of 2008 (H.R. 5840), which had a similar purpose of helping the Federal government build a knowledge base on insurance

The National Insurance Consumer Protection Act (H.R. 1880) was introduced on April 2, 2009, and the bill is in the beginning stages of the legislative process. The bill would establish the Office of National Insurance (ONI) in the Department of the Treasury; ONI would be represented by a Commissioner, with regulatory oversight over national insurers, insurance agencies, and producers.\textsuperscript{153} The Commissioner would have the authority to license, regulate, and supervise national insurance producers and insurance self-regulatory organizations, including registration. ONI would be composed of a Division of Consumer Affairs, a Division of Insurance Fraud, and an Office of the Ombudsman.\textsuperscript{154} The Commissioner would supervise, regulate, issue charters for national insurers and agencies, and establish standards for a national insurance holding company by examining, imposing fees, revoking charters for specified causes, implementing enforcement powers—including cooperation with foreign governments, and securing agreements with foreign insurance regulatory bodies. ONI also would cooperate with the National Council for Financial Regulators and the National Insurance Guaranty Corporation regarding systemic risk, including the risks of state-chartered insurers. The

\textsuperscript{153} The National Insurance Commissioner would regulate insurers, includes life, property and casualty, reinsurance companies, agencies, agents, and brokers, similar to how the Comptroller of the Currency regulates national banks. See Federal Overseer, supra note 92, statement of Ms. Bean, at 8.

national insurer, agencies, and insurance producers would be exempted from state supervision relating to the sale, the underwriting of insurance, and to any other insurance operations.\footnote{Id.} ONI would monitor insurance subsidiaries as well as the activities of the holding company in insurance affiliates, like AIG's financial products unit.\footnote{See Federal Oversee, supra note 92, at 8.}

2. Application of the principle-based approach

Insurance regulation has been different from any other financial sector such as the stock market, pensions, credit unions, and secondary mortgage trading savings and loans associations—which are all under federal supervision. Banks are under a dual-chartered system, but most big banks are nationally chartered and are under the strong influence of federal regulation through the federal-deposit insurance program and the actions of the Federal Reserve.\footnote{However, in the banking area, approximately 2/3 of the banks are state-based and are properly regulated by the states. See Thomas W. Bruner and Craig A. Berrington, State-Based Insurance Regulation under Scrutiny (January/February 2007), Wiley Rein LLP, available at http://www.wileyrein.com/publication.cfm?pf=1&publication-id=12783.} When Congress enacted the McCarran-Ferguson Act, it delegated authority to the states, with the exceptional federal involvement through subsequent federal statutes. The Act means that the state regulatory authority is not inherent or a natural right.

Now, establishing a federal insurance regulator is being debated in the U.S. Some support the state-regulation system—including the licensing function which is still efficient for small, state level insurance companies—but others disagree based on the
large companies which are relevant to several states and policyholders. Without reform of the state regulatory system, it is ineffective to supervise and handle complex issues properly. Although the pros and cons are debated, as is shown in the above sections, the strong movement for reform seems unstoppable, unyielding to form and precedent. It is time to evaluate new alternatives for modernizing insurance regulation. This dissertation evaluates and recommends reform under the following five standards: ensuring consumer and investor protection, securing the safety and soundness of the insurance institution, overseeing the integrity and fairness of insurance markets, monitoring and fostering the stability of the financial system, and enhancing the efficiency and effectiveness of regulation.

a. Ensuring consumer and investor protection

Federal involvement is required to ensure consumer and investor protection. The current regulatory structure of more than fifty-one separate regulations is inefficient, since it is duplicate and costly for consumers. For example, consumers cannot receive creative annuity products on a timely basis; but through some federal involvement, there could be faster approval of new products.\textsuperscript{158} After the terrorist attacks and Hurricane Katrina, the federal government lacked internal resources of information about the insurance industry, which increased the taxpayer’s burden and decreased the consumer welfare. The recent economic crisis also exposed the crippling lack of insurance information within the federal government and highlighted the significant role of

\textsuperscript{158} See Federal Oversee, \textit{supra} note 92, Statement of Mr. Royce, at 5.
insurance. For instance, downgrades of the bond insurers’ ratings and significant losses, resulting from their exposure to the U.S. mortgage market in 2007 and 2008, triggered tougher credit for municipalities and other bond issuers, even though the bond insurance carriers made up only 0.3 percent of total premiums written in insurance industry. In addition, the rating downgrades further contributed to the freezing of credit markets and general turmoil of the economic crisis. Moreover, the unprecedented intervention of the federal government by filtering taxpayer’s funding into the financial services holding companies, like AIG, was needed to cure unresolved monetary stringency and to prevent a systemic collapse.159

The current state guarantee fund is not enough to protect the interest of the investor and of insurance consumers. To secure future payments, it is very important that the asset management of insurance companies match long-term obligations; however, the state monitoring of financial health insurers is not enough to guarantee future payments against unpredictable economic changes. This discrepancy was also prevalent in the unprecedented loss in commercial real estate for life insurers, when they sought unavailable capital and surplus relief from state regulators in late 2008.160 Americans are increasing reliance on personal retirement savings, which also require the continuing monitoring ability of insurers to protect annuity product consumers, especially in the current unstable markets.161

159 See House Committee on Capital Servicers, Oversight Plan of the Committee on Financial Services for the One Hundred Eleventh Congress (hereinafter Oversight Plan) (Feb. 12, 2009), at 17, available at http://financialservices.house.gov/hearings.html

160 Id. Oversight Plan, at 17.

161 See Oversight Plan, supra note 157, at 18.
b. Securing the safety and soundness of the insurance institution

A federal regulator can secure the safety and soundness of the insurer's financial status. Some of states seem to be short of providing the expertise and system necessary to evaluate the risk coming from new insurance products and business models in insurance companies. For example, insurers, such as financial guarantee insurance carriers, develop their business model beyond traditional insurance to financial products like guaranteeing the credit value of more complex securities, including those backed by subprime mortgages. States must review the impact and provide regulatory tools to keep the insurer from insolvency, but there is no clear evidence that the state has monitoring systems and tools to prevent a financial crisis.

Actually, the principal regulatory tool is still controlling the insurance rates and insurance policies although a major concern must be prudent/solvency supervision to secure the insurance company and its future payments in the current state-based regulatory regime. These concerns may be the result of a political appeal to the insurance consumer. One of the reasons for the insurer's hesitation to establish new companies may be the overregulation of price by the state, usually through restraints on increasing prices because of political pressure to limit rates regardless of risk exposure, claim amount, or the actual loss ratio in the insurance market. However, by establishing a federal regulator, the unreasonable rate restrictions can be removed because the federal

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162 See Oversight Plan, supra note 157, at 15.

163 Elected commissioners are especially concerned about the insurance rate. See Scott E. Harrington, Repairing Insurance Markets, REGULATION SUMMER (2002). Eliminating the states' regulatory micromanagement of price and product cannot be achieved without federal intervention.
regulator would be free from election and political pressures, unlike the state regulator. Through the approval process, the state closely regulates the rates and policies of insurance that is underwritten. This kind of price control creates a heavy burden, drives up prices, and discourages innovation and new market access in the long term, although it does not endanger the prudence of the insurer.

c. Overseeing the integrity and fairness of insurance markets

Overseeing the integrity and fairness of insurance markets means employing effective, updated, globalized regulation but including regulatory development and market-based regulation. These functions can be fully implemented by federal regulation. Recently, insurance and financial trends are rapidly changing to globalize, integrate, and diversify. For approximately 150 years, state-based regulation with little direct federal interruption may have played an appropriate role in insurance industry, but changes in the insurance marketplace demand federal involvement and reform of the regulatory system. Insurance companies inherently involve traditional risks of doing business, but these risks expands with securitized products, several kinds of loans, saving-type products in domestic and international markets, and asset management, which includes dealing with the transactions of securitized and structured finance. There are suspicions whether individual states can keep up with the innovation and complex changes. In this

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164 There are at least seven different types of regulatory approval requirements. See Chapter 3, I. C, at 31.
165 See Blueprint, supra note 93, at 9.
respect, the supervisory and regulatory functions must change from the state to the federal level to match the current market development.

Although insurance has been regulated on a state-by-state basis, the business of insurance is not confined by state boundaries any more. The capital pools supplied by the reinsurance industry and the acceptance of international trade agreements have long since made the insurance industry an international industry. The current state regulatory scheme does not fit into the escalating, evolving global insurance marketplace.\textsuperscript{166} It is true that because of the fragmented stated-based system, there is no regulatory body to negotiate with foreign authorities on behalf of the U.S. market and there is no regulatory body with the ability to understand risks from around the world. In contrast, while America suffers with more than fifty-one separate markets and a divided regulatory system that cannot establish an international standard, the European Union keeps moving closer to the “Solvency II” phase, which will create one insurance market through all of Europe and increase the global cooperation endeavors by bringing in equivalent regulators from around the world.\textsuperscript{167}

d. Monitoring and fostering the stability of the financial system

AIG has received access to more than $170 billion in taxpayer funds, including $40 billion from the Troubled Asset Relief Program (hereinafter referred to as “TARP”)

\textsuperscript{166} See Oversight plan, \textit{supra} note 157, at 18.

\textsuperscript{167} See Federal Oversee, \textit{supra} note 92, Statement of Mr. Royce, at 5.
under the Emergency Economic Stabilization Act. Some other insurers have also wanted access to federal bailout funds via the TARP; however, the Treasury Department permitted the assistance for federally regulated entities only. Consequently, many insurance carriers have recently sought to alter themselves into savings-and-loan holding companies, which are subject to federal regulation. The carriers’ actions are further evidence of the need for federal aid and regulation for insurers in the U.S.

As part of financial systems, insurance plays a vital role in the American economy but can also endanger the stability of financial systems. Like commercial banks, failures of insurance companies also can affect the entire system on the basis of a financial-domino theory, and government must prevent or insure against that systemic financial crisis, as it did in the AIG bailout. Insurers, such as AIG and other insurance companies that invested municipal bonds, offer financially guaranteed products, and their holding companies can create systemic risks, as demonstrated in the financial crisis in the U.S. Federal regulators must monitor the possibility of weak financial markets and identify solutions to mitigate those kinds of systemic risks.

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168 The Emergency Economic Stabilization Act of 2008 (EESA) furnishes up to $700 billion to the Secretary of the Treasury to pay off mortgages and other assets that are blocking the balance sheets of financial firms and making it hard for working families, small businesses, and other companies to get credit, which is critical to a stable economy. EESA also establishes a program that would allow companies to insure their troubled assets. See Summary of the Emergency Economic Stabilization Act of 2008, the Washington Times (Sep. 25, 2008), available at http://www.washingtontimes.com/news/2008/sep/28/summary-emergency-economic-stabilization-act-2008/.

169 See Committee on Financial Services, supra note 159, at 16.


171 See Committee on Financial Services, supra note 159, at 16.
e. Enhancing the efficiency and effectiveness of regulation

First, any national insurance company can currently be regulated not just one time, but up to fifty-one times. Any national insurer has to abide by the different regulatory requirements and opinions of all states. As was mentioned, national insurance carriers are often dragged along by a state department due to requirements already met in neighboring state departments.

Second, market participants shop for the regulatory environment they want by evaluating and choosing a system and then moving to the corresponding state or federal regulatory jurisdiction.\textsuperscript{172} Congress must balance the need of consumers to get the most innovative and beneficial insurance products with the need for economic security and efficiency in the insurance industry. This balance cannot be achieved by the states or by the NAIC. The NAIC promised uniformity of product approval and coordination of the States several times but failed, even though some progress has occurred through federal pressure and mandates.\textsuperscript{173} Though the supporters of state regulation contend that the states can resolve the most crucial concerns by updating the current regulatory system, it is questionable whether this limited updating and modifying can solve fundamental problems. Based on past experience, the problem clearly cannot be solved by the state alone. For example, the disclosure of unified compensation for agents and brokers was implemented for consumer protection, but the rule failed due to non-unified states.\textsuperscript{174}

\textsuperscript{172} See Lawrence S. Powell, \textit{the Assault on the McCarran-Ferguson Act and the Politics of Insurance in the Post-Katrina Era}, Issue Analysis (Sep. 2007), at 13.

\textsuperscript{173} \textit{Id.} at 2-3.

\textsuperscript{174} For reference to further failure of reform, see supra note 98, at 16.
Third, the state-based monopoly regulation must be broken to allow for regulatory competition. While state-based regulation has existed from the beginning of the insurance business in the U.S., many people support federal government involvement, which is in strong opposition to the current state monopoly in the regulatory structure of the insurance industry. Currently the states alone continue to have the primary authority to regulate insurance today, but federal government involvement is necessary to protect against unpredictable risks and to accommodate the interconnected modernization of the financial system.

3. Comprehensive and consolidated regulatory system

In addition to involvement of the federal regulatory system in the insurance sector, the financial comprehensive and consolidated regulator must be considered. In other words, the banking, securities, insurance, and any other financial sectors have to be regulated and supervised in the form of government, quasi-regulatory agency or a regulatory panel of the government. Based on the experience of Korea, the U.K., Japan, and Germany, the consolidated regulatory system has lot of merits, even though some faults also exist.

With hindsight provided by the financial failure of AIG, a financial-service holding company with major insurance components, one could speculate that the current strict sector-by-sector supervision, such as banking, securities, insurance and any other financial sectors independently, should be supplemented. As explained in the related

testimony, AIG’s problem came from its parent holding company and its non-insurance divisions, including its securities lending operation. AIG’s non-insurance divisions are regulated at the federal level by the Office of Thrift Supervision (hereinafter referred to as “OTS”) because AIG chose the OTS to control AIG holding company as thrift. It is agreed that the problems with AIG actually resulted from excessive trading and credit default swaps out of AIG’s financial products unit in both London and in Connecticut, activities regulated by the OTS and not by state commissioners. Furthermore, the state had no power at the time to regulate the non-insurance operations, the credit swaps, or other financial products. In addition, neither the State Insurance Department nor OTS, which supervises the AIG holding company, had the exact information and risk assessment capabilities to cure AIG’s liquidity difficulties before the turmoil affecting AIG began. In his testimony, Mr. Eric Dinallo quoted the need to


177 See supra note 176. AIG was big and global financial holding company with more than $1 trillion in assets, which did business in 130 nations and had 116,000 workers and 74 million customers in 2008. AIG also owned 71 U.S-based insurers and 176 other financial services companies, including non-U.S. insurance companies at that time. AIG’s financial products unit and securities lending division, which was facilitated and funded by AIG’s insurance subsidiaries as a vehicle to make unwise bets on the U.S. housing market, sold lot of credit default swaps and guaranteed investment contracts to bank and any other financial institutions. At that time the leverage was 170 to 1. After subprime mortgage problem happened AIG was compelled to mark to market and post collateral not because of actual defaults on subprime mortgage, but because of concerns of defaults and the depressing market price of these securities. By marking its securities to market, AIG was forced to disclose losses, which kept growing. The AIG was also obliged to post added collateral against its credit default swaps because of downgrading its credit rating. Thus AIG received federal loan of $182.5 billion until in March 2009 to solve a liquidity squeeze because AIG’s assets were not liquid and could not be used to solve the collateral problem even AIG had enough assets. See also Federal oversee, supra note 92, (Statement of Mr. Royce), at 5.


179 See Federal Overseer, supra note 92, (Statement of Mr. Scott), at 6.

180 See supra note 92, at 7.
regulate the credit default swap market, "The absence of regulatory oversight is the principle cause of the Wall Street meltdown we are currently witnessing." Thus, the comprehensive and consolidated supervisory function is needed to prevent the blind spot of regulation in the financial market. The comprehensive regulator also can easily enhance expertise in examining insurance companies. Insurers deal with complex securities-type trading, loans combined with derivatives, and inter-businesses within financial groups. State insurance departments alone cannot maintain the growth or sufficiently advance the market and trading; the expertise of specialized professionals from different regulatory agencies must cooperate and monitor comprehensive risks in the insurance companies and the market. For example, the securities experts may examine the asset management of insurers. Experts also need to examine the holding company, working together to oversee the comprehensive risks of the whole holding company, because AIG, for example, used capital from its insurance subsidiaries with the approval of the many state insurance regulators, but the state insurance department could not assess the meaning and risk of the loans.  

\[181\] A credit default swap is an agreement under which the seller undertakes to pay the buyer if the insurance supplier of the bond cannot pay principal and interest. Credit default swaps can be used by the owners of bonds who want to protect themselves if the company that issued bonds is unable to pay the interest and principal. In those cases, the swap is insurance, because the swap buyer is like a homeowner insuring a home. But, just as with short selling of stock, most swaps are now used by speculators who do not own the bonds and the value of swaps outstanding are generally much more than the value of a company's debt. Swaps bought by speculators are known as "naked swaps" because the swap purchasers do not own the underlying bond.

\[182\] From experience in working at FSS, the comprehensive examination of holding companies or conglomerate at the same time, such as banking, securities, insurance, and other financial subsidiaries or related companies within same group is very effective to assess the entire risk and weak points of the market.
III. Regulators and Regulatory Structure in Korea

A. The FSC, FSS and KDIC

The Korean government agencies that regulate the insurance business are the Financial Services Commission (hereinafter referred to as “FSC”) and the Financial Supervisory Service (FSS). Before establishing a single comprehensive supervisory authority to oversee the financial industry in 1998, there were four separate financial regulatory authorities: the Insurance Supervisory Board (hereinafter referred to as “ISB”), the Securities Supervisory Board (hereinafter referred to as “SSB”), the Office of Bank Supervision (hereinafter referred to as “OBS”), and the Non-bank Supervisory Authority (hereinafter referred to as “NSA”). To overcome the financial crisis in 1997 and reform financial regulatory structure, the FSC was established in 1998 and the FSS was created by consolidating the ISB, SSB, OBS, and NSA into a single regulatory body in 1999.\(^\text{183}\)

In 2008 the Financial Supervisory Commission was integrated with the Financial Policy Bureau of the former Ministry of Finance and Economy (current Ministry of Strategy and Finance) to become the FSC,\(^\text{184}\) a commission that promotes effective oversight and better response to the market.

1. Financial Services Commission (FSC)

\(^{183}\) See INTERNATIONAL COOPERATION DEPARTMENT, FINANCIAL SUPERVISORY SERVICE FINANCIAL SUPERVISORY SYSTEM IN KOREA (December 2008), at 14.

\(^{184}\) The name of the agency was changed from Financial Supervisory Commission to FSC.
FSC is established for the purpose of integrating financial and supervisory policy functions, like BAFIN in Germany and FSA in Japan. Dividing the posts of the FSC Chairman and the FSS Governor provides for the separated functions of policy-setting and execution. The FSC has four main mandates: advancing the financial industry, stabilizing financial markets, promoting a sound credit system, and fair trading practices. FSC decides financial policy and enacts the regulation in the Korean financial market.

The main responsibility for insurance regulation belongs to the FSC. The Financial Services Commission (FSC) decides the financial matters and is composed of nine commissioners, however, the main functions of the commission are effectuated by the “secretariat,” which consists of public officers instead of the nine commissioners. These functions generally include:

- enactment and amendment of insurance business law, insurance business supervisory regulation, and the sub-regulations thereof;
- granting insurance business licenses (including licenses of the insurance agency and broker); and
- inspection and sanctioning of insurance-related institutions.

2. Financial Supervisory Service (FSS)


\[186\text{ See ACT ON THE ESTABLISHMENT, ETC. OF FINANCIAL SERVICES COMMISSION (Act No. 8863, Feb. 29, 2008) Article 17 (Affairs belonging to Financial Services Commission).}\]
The FSS is the supervisory authority that supports the consumer’s interests and regulates all of the financial institutions, like FSA in U.K. The FSS in Korea is a non-governmental body under the direction of the FSC. The FSS reviews and determines the fulfillment or failure of the licensing requirements; the FSS also supervises and examines financial institutions.

Under the direction of and based on delegation by the FSC, the FSS, as the executive arm of the FSC, does the following:187

- conducts daily supervision and examination of the operations and financial status of insurance-related institutions,
- approves and supervises insurance products,
- mediates insurance-related disputes; and
- performs other supplementary activities in support of the FSC’s regulatory functions.

3. Ministry of Strategy and Finance (MOSF)

The MOSF directs and coordinates major economic policies and makes fiscal policies, including tax-system design, budget formulation, and treasury management, and also takes the initiative in the field of international finance and international economic cooperation.188 MOSF does not have any authority to devise insurance policy but can

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recommend regulatory reform and insurance policies to FSC and FSS when the reforms or policies relate to macroeconomics or international finance.\textsuperscript{189}

4. The Bank of Korea and Korea Deposit Insurance Corporation

The Bank of Korea (hereinafter referred to as “BOK”) is the central bank which is a special juridical entity that has no capital. The primary purpose of BOK is the pursuit of price stability. The BOK sets a price stability target in consultation with the government and draws up and publishes an operational plan for monetary policy, including the stability target. The BOK also issues banknotes and coins, undertakes the operation and management systems, and exercises certain bank supervisory functions.\textsuperscript{190} The BOK indirectly affects the insurance industry: interest rates, payment system, and information sharing, etc.\textsuperscript{191}

The Korea Deposit Insurance Department (hereinafter referred to as “KDIC”) is the deposit insurance corporation that claims payments in case of bankruptcy or insolvency of financial institutions, including banks, securities companies, insurers, mutual savings banks, and merchant banks. The KDIC investigates insolvency accountability and files damage claim lawsuits against parties (usually officers, employees, and major shareholders of an insolvent financial institution) suspected of

\textsuperscript{189} The international finance policy is accomplished through the International Finance Bureau.

\textsuperscript{190} See The BOK homepage, Introduction, available at http://eng.bok.or.kr/broadcast.action?menuNavId=792.

\textsuperscript{191} It is debated whether to give the Bank of Korea direct supervisory power and how to limit its regulatory power in Korea. See http://news.mk.co.kr/outside/view.php?year=2009&no=491998.
having engaged in illegal or irregular actions to cause loss to the financial institutions.\textsuperscript{192} KDIC can participate with the FSS in examining insurance companies to investigate their prudency according to Deposit Protection Act.\textsuperscript{193}

B. Conflict among regulators

1. Regulatory structure debate: FSC versus FSS

There were several debates and changes to the supervisory structure and the regulatory framework in Korea. The problems that were raised are as follows:

- the double-layered or two-tire regulatory structure of FSC and FSS,
- the lack of recognized accountability for regulatory failures,
- the legal identity of regulatory authorities, and
- the lack of harmony among financial regulators.

After the 1997 financial crisis, the Korean regulatory structure was changed into an integrated financial supervisory authority with the creation of the FSC and the FSS in the late 1990s. There were two separate debates concerning which proposal was better to change the operational entity: merging the FSC and FSS into quasi-government type entities or into governmental agencies.\textsuperscript{194} The different proposals were raised by the former Planning and Budget Department and the Board of Audit and Inspection of Korea.

\textsuperscript{192}See KDIC, Functions, available at http://www.kdic.or.kr/english/introduce/mng_overview_01.jsp.

\textsuperscript{193}Neither BOK nor KDIC affects the licensing or business of insurance in Korea, but they have the right to examine jointly.

\textsuperscript{194}See Kim, Hong-Bum, The Problem and Reform Proposal of Financial Supervisory System (2008), Seminar on National Assembly Research Service (NARS), at 4-6.
Korean government agencies that regulate the insurance business are MOSF, FSC and FSS. Different from the past, the authority of the MOSF has decreased from being in charge of the international finance area to, now, supporting financial policies, which may have caused conflict with the main financial policy of FSC because international finance cannot easily be extracted from general finance.\textsuperscript{195}

Double-layered regulation has arisen mainly from the internal and external conflict and inefficiency between the FSC and the FSS. There have been inherent inefficiencies in regulatory and supervisory processes caused by the existence of the two distinct legal entities, FSC and FSS. Even though the FSC legally directs the FSS, in terms of supervision and examination of financial institutions, the policy and detailed executive actions of the two entities are sometimes different from each other, which causes confusion in the financial market, including the insurance industry, and causes demand for reform of the regulatory structure. For instance, FSS planned and implemented the Korean Turner report,\textsuperscript{196} which was prepared for proposing financial reform in Korea, but the proposed reform was postponed because the FSC was upset that the FSS published the report without consulting with the FSC. Another example was that the FSS announced permission for banks to short sell bonds, but the FSC immediately denied the policy in 2009, causing confusion to the financial market.\textsuperscript{197}

\textsuperscript{195} Until the establishment of the FSC, the MOFE (current MOSF) held chief responsibility for policy and regulation of the financial sectors, although the Bank of Korea had responsibility for the banking sector.

\textsuperscript{196} The Turner Report was the proposal of Adair Turner, the chairman of the U.K.’s Financial Service Authority, which contains a new regulatory regime for the financial service area. The report included a diagnosis of the current financial crisis, blaming the faith in the efficiency of markets. See Gren Manuel, \textit{At a Glance: Turner's Report}, wsj.com, (March 18, 2009), available at http://online.wsj.com/article/SB123737813434069551.html (last visited Feb 18, 2010).

\textsuperscript{197} See Kyunghyang News, FSC-FSS: Each and Every Event Discord...Disagreement of Policy Making (December 3, 2009), available at
The lack of recognized accountability for regulatory failures and the issue of the legal identity of regulatory authorities are related to the interference of outside influence and pressure from administration, politicians, and interest groups. These problems are also related to outside interference, which causes inner confusion and evasion such that the financial authority cannot take responsibility for regulatory failure. Some criticize the MOSF saying that it tries to gain influence over the FSC because the two agencies know each other well and have had instances of inter-ministerial personnel reshuffle. In these cases, FSC could not refuse the measures to boost the economy from MOSF or the “policy dominance,” such as the 2003 credit card crisis in Korea. Politicians can disturb the restructuring or liquidation of financial companies and can press to hinder it.

As the debate over the appropriate legal position and type of regulatory body, the academic side seems to support a quasi-governmental body, but the governmental side asserts that the regulatory power must belong to the government. Some argue that the FSS was not responsible and not accountable for the financial crisis because the FSS lacks authority. For the FSS, the role of supervision and policy-related reform is restricted because FSC has the broad decision making function, including licensing, market activities, and solvency standards—excluding examination and inspection—nevertheless FSC was not responsible for specific regulatory failures. For example, the investigation of the 2003 LG card crisis by the Board of Audit and Inspection of Korea resulted in the determination that only one member of FSS had responsibility for not sharing information with the FSC, even the expansion policy of credit cards was decided


Kim, Hong-Bum, supra note 194, at 9.
by MOFE and the FSC at that time. This situation has the implication that there is a significant amount of implied conflict and distortion between authority and responsibility in the Korean regulatory system.

2. Regulatory competition or confusion

It is problematic that the number and power of regulatory authorities are increasing in Korea.\textsuperscript{199} A lack of harmony comes from the deficiency of checks and balances among FSS, BOK, KFTC, and KDIC and from a misunderstanding about the payment and settlement or guarantee system or fund. BOK and KDIC continually have demanded\textsuperscript{200} and expanded the authority to examine financial institutions.\textsuperscript{201} If those demands become real, the burden on financial institutions will increase to meet the requirements and support the increased authority of BOK and KDIC to examine. FSS and FSC refused the proposal by BOK and KDIC for individual and independent examination for several reasons; however, the Revising Related Act enabled BOK and KDIC to co-examine without objection in certain conditions. In addition, the Related Memorandum of

\textsuperscript{199} Some members of the National Assembly of the Republic of Korea proposed to establish the Korean Consumer Financial Protection Agency under the FSC. \textit{See} Seoul Economics newspaper (March 15, 2010), \textit{available at http://economy.hankooki.com/lpage/politics/201003/e2010031518011493120.htm.}

\textsuperscript{200} The true reason to expand the examination power to financial institution seems to increase the political influence and exercise the policy through informal channel easily.

\textsuperscript{201} It is legally binding to accept the request of joint examination by KDIC to FSS from the Depositor Protection Act, Article 22 that “(3) The Corporation may ask the Governor of the FSS … to conduct an examination of an insured financial institution and the financial holding company … and deliver the results of the examination, or to allow a member of the Corporation to participate jointly in the examination of such insured financial institution and financial holding company… by setting the specific scope as deemed necessary to protect depositors and maintain the stability of the financial system. In this case, the FSS Governor shall comply with such request, regardless of the provisions of Article 66 (3) of the Act on the Establishment, etc. of Financial Supervisory Organizations.”
Understanding (MOU) and other procedures were prepared among regulators, but BOK continued to make independent and exclusive examinations against financial institutions such as banking and securities firms.\textsuperscript{202}

C. Reforms for symbiotic regulation

3. Alternative regulatory framework for insurance

Consolidating into one financial regulator is ideal to avoid conflict between the regulators, the FSC and the FSS. A consolidated regulator also can avoid the lack of accountability for regulatory failures and the issue of the legal identity of regulatory authorities in Korea. Because making judgments of qualified information is critical, the financial authority must have knowledge and information to produce the best results. The current two-tier structure prevents this process because the decision-making authority belongs to the FSC, but the knowledge and data are within the FSS. This structure can create serious obstacles for the efficiency of regulatory and supervisory processes.

Reassessing the present two-tier regulatory structure of FSC and FSS is recommended, and considering alternative organizational structures that could implement greater operational independence and efficiency of regulation is also recommended. Thus, it may be appropriate to consider integration of the FSC and the FSS, as a single quasi-governmental body with independent overseeing authority provided by a non-

\textsuperscript{202} See Korea's Financial news, Why BOK examine the securities firm?, (Jan. 25, 2010), ) 026 securities section, available at http://www.fnnews.com/view?ra=Sent0701m_View&corp=fnnews&arcid=100124220354&cDateYear=2010&cDateMonth=01&cDateDay=25 (Korean version).
operational board—like the current FSC but without the secretariat and public official staff—comprised of members from the government and the private sector. To improve specialty and flexibility in regulating insurance, the quasi-governmental type regulator is a better fit than a strict and obedient governmental body. Thus, the consolidated quasi-governmental regulator is ideal, and an existing, exact example is the FSA in the U.K. Achieving operational independence for the financial regulator from political, administrative, and commercial interference, the quasi-governmental body is a better system than governmental system. 203

To implement proper regulation, the regulatory authority, which would be able to implement on-site examination and off-site monitoring, must fulfill the whole regulatory process from licensing, solvency, market conduct to liquidation; however, the current regulatory system overemphasizes the role of the FSC although the practical regulation is done by the FSS. The pure financial policy function must be returned to the MOSF to support economics policy, and the supervision and examination function must belong to the FSS. If it is practically impossible to achieve right now or if it takes time, the next choice can be rearranging the authority and responsibility. This arrangement must be done to avoid conflict and to promote effective and efficient regulation, and the arrangement can be done by increasing the role of FSS, which also must be accompanied by symbiotic cooperation between the FSC and the FSS in Korea.

4. Symbiotic harmonization of the BOK and the KDIC

The BOK has tried to achieve sole examination power by revising the Bank of Korea Act; however, the off-site monitoring function of the BOK should focus solely on managing the economy, payment system, monetary policy, foreign exchange, and price stabilization. Currently the BOK does not include the insurance industry in its joint examination procedures, but if an insurer uses a payment function, the BOK might demand joint examination with the FSS, as it does with the securities firms. The BOK’s plan to oversee the payment and settlement system by examining banks, securities firms, and other financial institutions must be canceled, but the BOK should allow access to the information obtained by FSS. If the BOK is involved in the regulation of banks, the BOK might sacrifice banks to bust up the economy or prioritize economic growth over the safety of banks. The BOK and its supporters argue that its regulatory work, including examination, is required for the understanding of finance and the economy, but accessing proper information to understand the financial system while retaining a backup regulator is enough.\textsuperscript{204} However, until the BOK has a joint examination right with the FSS under statute, the cooperation between FSS and the BOK is required to achieve the purpose and meaning of the organizations. For proper procedure and execution from the two regulators, the applicable laws and memorandum of understanding (MOU) must be observed and developed.\textsuperscript{205}


\textsuperscript{205} In the Bank of Korea Act, Article 28 and Article 88 (Request for Examination, Joint Examination, etc), the joint examination is described: “12. Requests for the FSS to conduct on-site examination and joint examination with the BOK on banking institutions subject to the proviso that this is necessary for the formulation of monetary and credit policies” and “(1) the BOK may, when the Monetary Policy Committee deems it necessary for the implementation of its monetary and credit policies, require the FSS ... to examine banking institutions within a determined specific range and, when necessary, it may require the FSS to have employees of the BOK participate on a joint basis in the examination of banking institutions.
The checks and balances in the regulatory system also have to be enhanced to support effective regulation and to protect against regulatory failure. The KDIC protects against the insolvency of financial institutions, including instances of mergers and acquisitions, asset transfers, and arranging financial support as a guarantee fund to maintain the stability of the financial system. The KDIC also has sought to expand the joint examination power to extend operating power. To resolve the conflict between the FSS and the KDIC regarding joint examination, the KDIC must turn the focus from on-site examination of financial institutions to off-site monitoring and sharing information instead. The KDIC also must develop risk-based premiums to guarantee equal allotment of premiums among financial institutions. If the FSC and the FSS merge in the future, the function and power of the KDIC to achieve checks and balances in Korean financial regulatory system might strengthen.

In such cases the FSS shall comply without delay. (2) The BOK may request the FSS to submit the findings of examinations carried out ... and on the basis of these findings to take the necessary corrective measures against the banking institutions concerned. In such cases the FSS shall comply.”

206 See Resolution of Insolvent Financial Institutions, KDIC Homepage, [https://www.kdic.or.kr/english/introduce/about_roles.jsp](https://www.kdic.or.kr/english/introduce/about_roles.jsp) (Major Operations).

207 KDIC’s main function is restructuring financial institutions, but as the assigned work is decreasing, KDIC seeks to find additional legal duties and power to maintain or increase organization and political power.
Chapter 4: Reform to Market Access

I. Heavy burden to market access in the U.S.

Because there are no national license issuers or federally unified laws to preempt state license requirements, insurance companies, agencies, and producers cannot operate in the entire United States without fulfilling the requirements of the fifty states’ insurance laws.\(^{208}\)

A. Regulating licenses of the business of insurance

There are a lot of regulatory tools to regulate the insurance industry. They include financial regulation, rate and product regulation, fair competition/solvency standards, and licensing. Without licensing procedures, buyers can purchase insurance policies from unlicensed insurers, which can cause problems for future payment protection through guarantee funds, certain tax concessions, indemnification, and other consumer protections, including protection against unfair rates because unlicensed insurers are not covered in guarantee funds, certain tax concessions, etc. Thus, statutes have regulated unauthorized businesses in the U.S.\(^{209}\) and Korea.\(^{210}\) Regarding the meaning of the “business of

\(^{208}\) Meeting each state’s requirements means that there are over 51 requirements for licensing in the 50 states, the District of Columbia, Puerto Rico, Guam, and the Virgin Islands.

\(^{209}\) See e.g. Kentucky Revised Statute 304.11-030 (Prohibition of unauthorized insurance business), available at http://www.lrc.state.ky.us/KRS/304-11/030.PDF. See also Nutting v. Massachusetts, 183 U.S. 553 (1902). The court also upheld a state statute that prohibits the advertisement of unlicensed insurers’ products within the state.
insurance," single or isolated acts are included in its meaning but preliminary acts do not constitute business of insurance transactions or "taking risks"; mere beginning negotiation for a contract is not doing business in the U.S.\textsuperscript{211}

Licensing is one of the most significant and dominant tools for controlling and regulating access to the market. Licensing provides the regulator with the ability and influence to fix the market share through which insurers can access profits. Licensing requirements set up minimum acceptable standards of insurers' financial strength. In other words, the regulator can expel insurers from the market by setting high financial-prudence standards. In general, applicants wishing to establish an insurance company in a jurisdiction must secure a license to be admitted (or authorized) insurers.\textsuperscript{212}

The insurance consumers cannot be protected properly if they buy insurance policies from unlicensed insurers. Almost all countries at one time or another have prohibited their citizens from purchasing insurance from non-admitted insurers. Although purchasing through non-admitted insurers is prohibited, such purchasing has been permitted where the legally required commercial coverage is unavailable locally. The excess-surplus line of insurance or reinsurance is an instance when the local licensed reinsurer cannot underwrite the original insurance product.\textsuperscript{213}

\textsuperscript{210} See Insurance Business Act (Act No. 8902, Mar. 14, 2008) [hereinafter referred as "IBA"] Article 3 (Conclusion of Insurance Contracts). No one shall enter any insurance contract with any person who is not an insurance company, broker, or insurance contractor acting on behalf of an insurance company.

\textsuperscript{211} See JOSEPH ASBURY JOYCE, A TREATISE ON THE LAW OF INSURANCE OF EVERY KIND (1917), at 770.

\textsuperscript{212} However, when some overriding social issue is raised, the private market fails to provide some perceived need, and no market-based solution seems feasible, the government sometimes serves as a supplier of insurance, such as a national healthcare provider, without following licensing procedures.

\textsuperscript{213} This discussion draws mainly from Kwon (2007). See supra note 11.
Equal treatment against foreign insurers means that foreign entrants must be dealt with no less favorably than domestic companies. Thus, licensing requirements normally are applied non-discriminatorily between (1) a state's domestic insurance companies owned by nationals and those companies owned by foreigners (i.e., national treatment), and (2) domestic insurance companies and foreign insurance companies (i.e., most favored-nation treatment)\textsuperscript{214}. If the equal treatment issue is arisen the standard to verify the violation of Equal Protection Clauses of the Constitution is whether the classification is rationally related to the legislative purpose.

B. Obstacles to establishing an insurance company

Insurer must meet multiple states’ standards to establish an insurance company. The rules and procedures are complex and different in each state, which results in costly inefficiencies. The inefficiency of state license regulations is attributed to the direct and indirect costs of compliance with rates, policy forms, and other licensing standards. The costs and delays are heavy burdens to the multistate insurance companies that must confront the conflicts among multiple states’ laws and procedures, even in this financially modernized environment.\textsuperscript{215} Many consumer groups and insurers have criticized the inconsistent state regulations that drive up costs and limit product innovation and

\textsuperscript{214} These principles seem to be relatively well observed in the U.S.

The licensing of the insurance business is heavily regulated in the U.S., and each individual state has an insurance department that implements state legislation governing license requirements and reviewing procedures as set forth in the state insurance code. Therefore, insurers that do business in multiple jurisdictions must repeatedly expend time and capital to fulfill the similar but unique procedures of each state’s requirements. These procedures hinder the efficient operation of insurers and make it difficult for new domestic insurers and foreign insurers to access the market.

II. Establishing a federal licensing standard in the U.S.

The current multiple-state-based supervision cripples domestic companies and makes foreign companies hesitant to enter the insurance market. An OFC would permit national insurers to do business throughout the U.S. without state licensing and entry restrictions, which would reduce the burden to market access. Insurers would save time and money by not administering and complying with diverse regulations across the states.

Licensing a new insurance company in every state is almost always a painstaking and costly process. Attempting to innovate and update insurance products is even tougher.


217 See Harrington, supra note 215, at 41.

218 Currently, there are almost 7,200 insurers that are subject to regulation in the U.S. If insurers violate regulations, the states may exact fines or suspend or revoke their licenses, in 2000, approximately 300 insurance carriers got their licenses suspended or revoked. See supra note 109.

219 Scott supra note 163, at 3.
To grant licenses, the regulator's status had to be decided in the beginning of insurance regulation. The main issue concerned who got the power to regulate in the U.S: the federal government or the state governments.

C. Creating a federal regulator to issue licenses

Some reforms, such as the National Insurance Act of 2007 (H.R. 3200), provide an OFC (optional federal charter) to allow insurance carriers to choose regulation at the federal level instead of at the state level. An OFC enables the state-based regulatory system to be kept in place for insurers but provides the option to displace the multi-state needlework regulatory system with a national regulatory framework that provides uniformity. The option will allow insurers and agents to choose federal

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220 See supra note at 1, the regulatory systems of other developed countries are totally different in licensing business and approving insurance product. For example, the European Union member countries of the European Union, there is now have a “passport” system, which means, simply speaking, that if a German insurance company is licensed in Germany, it can do business from Italy to Poland.

221 See Kwon, supra note 44.

222 Early proposals can be tracked to the mid-19th century; proposals for federal licensing or regulation are not recent movements. Examples include the Dryden Bill S. 7277 (1905), the Dodd Bill S. 3919 (1966), the Brooke Bill S. 3884 (1977), the Dingell Bill H.R. 4900 (1992), the State Modernization and Regulatory Transparency Act (2004), the Nonadmitted and Reinsurance Reform Act (2006), the National Insurance Act (2006), and another National Insurance Act (2007). See John Dembeck, Debevoise & Plimpton LLP, Insurance Regulation In a Nutshell (2008).


224 With this new federal regulation, banks basically can choose either a national charter under the regulation of the Comptroller of the Currency or a state charter under the state's regulation. To participate, the state must become a member of the Federal Reserve System or insure through the Federal Deposit Insurance Corporation. See Robert D. Eager and C.F. Muckenfuss III, Federal Preemption and the Challenge to Maintain Balance in the Dual Banking System, 8 N.C. Banking Inst. 21 (2004), footnote 7.

regulation, exempting them from state-regulated requirements and entry barriers. The practice of the states primarily regulating the insurance industry has been criticized. The practice brings the burden of compliance to overlapping or contradicting rules, of limits on the innovation of products and businesses, and of decreased competition among insurance companies. Under the current state-based regulatory structure, each state insurance department is a “monopoly insurance regulator with the state.” Each state may compete with other states, but the state hesitates to encourage jurisdictional competition because they fear that the competition might bring federal intervention and regulation. State-based regulation also weakens U.S. insurance companies’ competitive status in the international markets.

1. Summary of recent OFC proposals

The first OFC proposal was reportedly introduced in 2001 and then resurfaced as the National Insurance Act of 2007 in the 110th Congress. Several, varying proposals were introduced, but the common concept was the creation of a dual regulatory system.

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226 See supra note 172, at 1.
227 See Baird Webel, supra note 71, at 2.
228 See Butler & Ribstein supra note 35, at 3.
229 Id.
230 See Butler & Ribstein supra note 35, n. 4.
231 A draft of this proposal contained that the chartering, supervision, and regulation of National Insurance Companies and National Insurance Agencies to be administrated by the Treasury Department. The proposed agency was the Office of the National Insurance Commissioner. The commissioner would be appointed by the President, subject to Senate confirmation, and serve a five-year term. This position has been removed from most state insurance laws for national insurers and agents. See Baird Webel, supra note 71, at 7.
which may have arisen from the current banking regulatory structure. OFC bills normally propose to establish a federal insurance regulatory agency and allow insurers to select the charter. Federally chartered insurers would then be exempted from most state insurance regulations. The federal regulator would be managed by the Secretary of the Treasury, but the Secretary would be prohibited from interfering with specific matters before the commissioner. The budget for the office would mainly be based on the fees from and assessments on insurance companies. The federal-based insurers, agencies, and producers would be able to do business in the entire U.S. without observing the separate requirements of the fifty states' insurance laws. Some significant aspects of the bills include the following:

- The federal system would apply to all lines of insurance except title insurance;
- National insurers would not be subject to rate regulation but would be regulated regarding insurance policies;
- Fees would be assessed for operating within the federal system, and those fees will cover the cost of the regulatory system;

232 See Baird Webel, supra note 71, at 2.

233 This federal body can be an independent governmental organization or internal department of the Secretary of the Treasury, but has the function of regulating the insurance industry.

234 See Baird Webel, supra note 71, at 4-5. This bill includes lessening the rates and amount of regulation. Some of the current state-based regulations have prior-approval requirements for changes to rate and policy forms, while the national regulator would just require insurers to keep the copies of the policy forms that they use. The federal regulator would provide the general standards and would require filing forms with the commissioner before use by the federal-chartered insurer.
- The states could continue to collect premium taxes from national insurers, so the states would not suffer the loss of revenue from premium tax;\textsuperscript{235}

- States could require the participation of national insurers in the states’ residual market\textsuperscript{236} entities to cover all costs incurred; and

- The national insurers would no longer be exempt from the application of federal antitrust laws, except to the extent that state laws continue to apply the exemption to national insurers in specific.

2. Arguments against an OFC

The following are arguments of the opponents to the OFC proposals:

- There are some insurance lines so reliant on the states that a national regulatory system cannot be effective. Liability insurance is directly tied to state tort laws, and automobile insurance has requirements that are entirely state specific. Thus,

\textsuperscript{235} However, the states would be prohibited from imposing additional taxes on national insurers or agencies. Surplus lines insurers may be taxed where the insurer maintains its principal place of business or residence. \textit{See} Baird Weble \textit{supra} note at 12.

\textsuperscript{236} \textit{See} Insurance Information Institute, \textit{Residual Markets}, (November 2009), available at \url{http://www.iii.org/media/hottopics/insurance/residual/} (last visit at December 15, 2009). Residual markets exist to assure that insurance policies are available when insurance companies in the regular market reject high-risk applicants. In a normal competitive market, insurers can freely underwrite and choose the insureds among applicants, such as drivers and property owners. However, if the applicants are high-risk applicants, it is difficult to buy coverage from the regular insurance carriers. To make buying an insurance policy easy for any applicant, special insurance plans within the residual market have been arranged by state regulators. Residual market plans provide for normal underwriting where in other situations high rates would be charged to high-risk policyholders, and the state or all insurance consumers absorb the additional costs. But, in a few states, insurance companies cannot get their residual market losses back, and political pressure keeps rates from rising to the proper actuarial level. Lawmakers and regulators enact laws that address availability, rate adequacy, and other factors that affect underwriting decisions.
to satisfy local needs in policymaking, the state regulatory system must be maintained.\textsuperscript{237}

- A federal regulatory system cannot guarantee efficiency, improvement, and regulatory competition;
- The states have regulated the insurance industry from the beginning of the business of insurance without material faults;
- The NAIC promotes the uniformity and modernization of insurance regulation;\textsuperscript{238}
- There is no money for a federal guarantee fund, and transferring money may weaken the state fund; and
- To maintain the federal antitrust exemption, the state has to regulate the insurance industry.\textsuperscript{239}

\begin{itemize}
  \item Centralization fits only some insurance lines
\end{itemize}

The necessity for insurance may be heavily linked to state substantive law, such as automobile insurance and workers' compensation law. In addition, the nature of the property and casualty insurance markets is local. Exempting federally chartered insurers' participation in state residual markets would be impossible.\textsuperscript{240} Therefore the advantages

\begin{itemize}
  \item to satisfy local needs in policymaking, the state regulatory system must be maintained.\textsuperscript{237}
  \item A federal regulatory system cannot guarantee efficiency, improvement, and regulatory competition;
  \item The states have regulated the insurance industry from the beginning of the business of insurance without material faults;
  \item The NAIC promotes the uniformity and modernization of insurance regulation;\textsuperscript{238}
  \item There is no money for a federal guarantee fund, and transferring money may weaken the state fund; and
  \item To maintain the federal antitrust exemption, the state has to regulate the insurance industry.\textsuperscript{239}
\end{itemize}

\textsuperscript{237} See Gregory Serio, \textit{Testimony of the National Association of Insurance Commissioners Before the Committee on Banking, Housing, and Urban Affairs United States Senate Regarding: The State-Based System of Insurance Regulation}, at 3.


\textsuperscript{239} See Harrington, \textit{supra} note 215, at 63.

\textsuperscript{240} See \textit{supra} note 236.
of centralization are probably limited in certain insurance products. Thus, the state regulatory system can satisfy local needs in policymaking. However, it can be argued that limiting rates for high-risk applicants by state regulation can cause cross-subsidies and conflict between regulators.

b. Federal regulation may produce abuse, and regulatory competition is impossible

The results of a state’s failure in or misleading regulations may be limited within the state, but federal regulation errors would be able to spread across the state borders. Due to the politically sensitive nature of insurance coverage, federal regulation could ultimately lead to restrictions on rates with harmful results for the private sector’s risk management and resource allocation. The threat of a costly overlay of a new federal bureaucracy may be anticipated, but it will be easier to change and reform one federal body than fifty different states. It seems too late to turn back the wave of reforming regulatory schemes by proving the danger of a federal agency’s demerits. The likelihood of a “race to the bottom,” as state and federal regulations race to give insurance companies more favorable treatment, suggests weak regulation and small budgets which can result from “race to the bottom”. However, the regulatory standard balances a prudent financial standard with a solvency standard and competition with deregulation;

\[241\] It is also contended that the diversity of state regulation can reduce the impact of bad supervision. In theory, the states also can compete and innovate through their diversity. However, the practical data and evidence to support this argument is unavailable. See Webel, supra note 71, at 3.
thus, the supervisory authorities can handle the proper regulatory reform lines by regulatory competition.\textsuperscript{242}

It is certain that an OFC could enhance regulatory competition and help reduce the regulatory excess if most insurers could switch charters at a relatively low cost. In the short run, an OFC can provide strong motivation for further state reforms. In the longer run, the ability of federally chartered insurers to switch to state regulation might discourage inefficient federal regulation. On the other hand, the largely fixed costs associated with adopting an OFC will disadvantage small and medium sized insurers that switch to federally chartered insurers.\textsuperscript{243}

c. The states have regulated the insurance industry without material faults

The states have been regulating the insurance industry well, without material faults from the beginning of the insurance business. The McCarran-Ferguson Act allegedly delegated the regulatory authority to the states, since the states should have the primary and preemptive responsibility for the regulation of insurance. However, in fact, the states regulated the business of insurance since insurance companies first began operating in the U.S. For more than 150 years, the supervision at the state level controlled prudential standards and market conduct. In addition to fulfilling their

\textsuperscript{242} Some skeptics question whether huge federal involvement is necessary. For example, after adopting the Sarbanes-Oxley Act, which increased federalization of formerly state-dominated corporation law, large costs and other problems arose for publicly traded companies. See Butler & Ribstein supra note 35, at 8.

\textsuperscript{243} See Harrington, supra note 215, at 63.
responsibilities, a practical and strong reason for continuing state regulation is that the states gain over $10 billion per year in tax revenues from premiums as accumulative amount. With this strong motivation, state regulators place consumer protection as the first priority. While state regulatory systems are not perfect, they have worked well even with the failures of insurance companies.

Some states directly elect the commissioner so that the state has the strong incentive to do the job effectively at the state level. However, commissioner elections and innovation are not closely related, and one state’s innovation hardly affects the other states’ regulatory schemes because the interests and environments of each state are often different from and oblivious of each other.

d. The NAIC works for uniformity

The NAIC works for uniformity of regulation and modernization of the insurance industry. States also well recognize the need for modernization and uniformity and make progress with the NAIC. State insurance regulators acknowledged that the passage of the Gramm-Leach-Bliley Act (hereinafter referred to as “GLBA”) has created the need

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244 Premium taxes on insurance are significant because they are an important source of revenue for the states’ general funds. States collected about $15.7 billion in premium taxes in total, which was approximately 2% of state tax revenues. “State Government Tax Collections” US Census Bureau, available at http://www.census.gov/govs/statetax/, (last visit at Dec. 20, 2009).


246 See Baird Webel supra note 71, at 3.

to modernize state regulations. In fact, GLBA imposed two specific requirements\textsuperscript{248} on state insurance supervisors in return for continuing state regulation of the business of insurance. States have begun the highest priority change: change from the complex system, including prior regulatory approvals, that slowed the availability of insurance products for consumers.

Despite the NAIC's status as a voluntary organization of supervisors, the NAIC has aggressively pursued a consensus for improvements to the present system. The NAIC and the states especially try to reform the rate system with efforts such as introducing the Coordinated Advertising, Rate and Form Review Administration (CARFRA), which would pool regulatory resources from several states to generate a speedier approval process.\textsuperscript{249}

e. A federal guarantee fund may increase the federal burden and weaken the state fund

A federal guarantee fund that could cover the obligations of insurers is an essential part of effective regulation by the OFC. The potential benefits from regulatory competition may be assessed in increased safety and soundness of the federal and state guaranty program. However, the establishment of a federal fund may weaken the state guarantee system because a number of federally chartered insurers will withdraw from the states' guarantee funds. In the long run, a federal guarantee system would likely expand to protect both federal- and state-chartered insurers together.

\textsuperscript{248} The requirements are uniformity of producer licensing and rate and policy form standardization.

\textsuperscript{249} See http://www.insurance.state.pa.us/assets/download/carfra.pdf.
The danger is that the federal guarantee system might repeat some of the mistakes of the state deposit system and bring moral hazards to state and federal insurers, such as the “too big to fail” notion. In addition, an OFC would not encourage market discipline but would place more reliance on regulation than before.\textsuperscript{250} Some skeptics contend that the increasing number of federally chartered insurers will reduce state premium taxes and damage the states’ budgets, however, the OFC proposal contains provisions that perpetuate the collection of premium taxes for the states.\textsuperscript{251}

\textbf{f. The states must regulate the insurance industry to maintain the antitrust exemption}\textsuperscript{252}

The OFC would substantially eliminate the antitrust exemption for federally chartered insurers. That change could damage the integrity and value of the current system of information sharing, which saves the industry from unnecessary competition, from high costs of ratemaking, and from objective standards to compare prices. Application of federal antitrust law would undermine small and medium insurers, which cannot have exact rate pricing but often play an important role in the insurance niche market. This federal application will also alert the state antitrust regulator to check whether the insurance practice proper or not.

\textbf{D. National standard alternative}

\textsuperscript{250} Harrington, \textit{supra} note 215, at 63.

\textsuperscript{251} See \textit{supra} note 92, at 6.

\textsuperscript{252} Harrington, \textit{supra} note 215, at 63.
1. Creating a federal single-license requirement and maintaining parts of the status quo

The problem of current multi-jurisdiction and multistate-based regulation triggers increasing federal involvement and regulation of the insurance industry; however, the creation of federal authorities also brings much criticism, especially claims of the abuse of federal government power and of the inefficiency of the federal bureaucracy, which can fail to use the federal regulatory system because the main motive to create the federal regulator system is efficiency, no the bureaucracy. Thus, some supporters propose introducing the single-regulatory-standard approach, including single-license requirements that preempt the states’ license requirements, but reserving the main regulatory function for state authorities. This hybrid plan potentially can remove the concern and the criticism against the federal optional charter and promote innovation and competition in insurance rates and policies while reserving the regulatory role for the state.253

2. The State Modernization and Regulatory Transparency (SMART) ACT

The State Modernization and Regulatory Transparency Act (hereinafter referred as “SMART Act”) was proposed to create minimum bounds for the regulatory standards set by the states, including standards governing rates, policy forms, license-related insurers and producers, market activities, reinsurance matters, and insolvent-insurers

receivership. The SMART Act also suggested establishing the National-State Insurance Coordination Partnership, which might consist of three state commissioners and three federal commissioners headed by a President-appointed chairman. The Partnership would not have direct regulatory power but would follow the NAIC model laws if the states failed in their regulations.

SMART Partnership was designed to preempt state standards in contrast to a federal takeover, if states fail to observe minimum standards. However, the problem is that the distinction between the federal role and state authority is not clear; for example, the federal authority cannot set up minimum standards without dominating related, dependent fields.

E. Recommendation to establish an optional federal charter

It is generally understood that Congress can attain the needed reforms through an OFC or by enacting federal standards. No one can be certain that the federal regulation will actually accomplish the ultimate reforms and completely solve the problems, but a innovation can be achieved by regulation on the federal level with continuing improvement in the future. An OFC may also promote regulatory competition by giving the states immediate motivation to modernize the regulatory system. The main end goals of regulatory reform are to provide one-stop approval or certification and to have all rates, risk classifications, and covered benefits decided by competition rather than regulation.

254 See Hearing SMART, supra note 247, at 87-122.

255 See supra note 216, at 12.

256 Id.
Competition also can enhance private market incentives for a strong and sound insurance industry. An OFC will offer the potential to reach a more streamlined, less duplicative system.\textsuperscript{257} Also, it will be easier to reform one authority than to change fifty-one different jurisdictions through the NAIC, which has no actual power.

From the OFC proposal we can learn the key concepts regarding licensing. The OFC proposal contains plans for licensing reform. The proposal requires a federal charter; the commissioner of the federal charter would be required to value the character and competence of the applicants and their financial assets. Most importantly, if an application is denied, the commissioner would be obligated to issue an explanation of the denial. The commissioner would be prohibited from imposing additional conditions on non-U.S. insurance companies unless these conditions were vital for the protection of the policyholders and justified in written findings.\textsuperscript{258} In addition, a national agency would be expressly allowed to sell surplus lines insurance because reinsurance/surplus line is needed to protect the insurer.

To be a controlling shareholder or have a controlling interest in a national insurer or agency, a person must have permission from the commissioner. Such permission would be automatic unless the commissioner specifically finds that the transfer of control would do or be the following:

- cause the insurer or agency to be unable to keep the requirements for a federal insurance license;
- put the financial stability of the insurer or agency in danger;

\textsuperscript{257} See Scott, supra note 163 at 12
\textsuperscript{258} See Webel, supra note 71, at 9.
• be unfair or unreasonable to policyholders;
• put the control of the insurer or agency in the hands of an entity that lacks competence, experience, or reliability; or
• be dangerous to the insurance consumers.\textsuperscript{259}

These clauses, however, must be adjusted for clarification because their meaning is too broad and ambiguous to apply to practical cases.

Mergers of national insurers and agencies would require the approval of the commissioner, who would be directed to set up regulations and procedures for approval. Also, a non-U.S. insurance company with a branch in the U.S. would be required to have approval to domesticate its U.S. branch.\textsuperscript{260}

Establishing an OFC instead of enacting federal regulation to exempt state regulation is recommended by the following arguments:

• State-based regulation leads to unnecessary overlapping and costs of regulation, such as duplication of filings and licensing fees in each state;\textsuperscript{261}
• The current regulatory environment obstructs innovation, competition, and investment, including limiting products and inhibiting not only national but also international competitiveness such that the flow of new investment in the insurance industry moves to areas with more rational regulatory systems; \textsuperscript{262}

\textsuperscript{259} See Id.
\textsuperscript{260} Id.
\textsuperscript{261} See Id.
\textsuperscript{262} See Id., at 3.
• A market-based optional federal charter can help enhance supervisory competitiveness and protect consumers by providing for choice among options of insurance companies and products;\(^{263}\) and

• The U.S. economy is unstable but continues to become more complex than before. The current insurance regulatory framework cannot accept above changes which can lead complexity for the economy, and so it continues to be hindered in terms of effectiveness and viability.\(^{264}\) The current supervisory system lacks consistency and efficiency, so the OFC reforms must be accomplished. This conclusion is supported in detail in the arguments below.

1. State-by-state regulation unnecessarily overlaps and burdens

The motivation for regulatory reform may stem from a desire to relieve duplication and overregulation problems.\(^{265}\) Insurance is an interstate business in nature, so insurers must comply with more than one state’s requirements when those insurers sell insurance products. Insurance companies must observe each state’s regulations of rates and policies, such as prior approval for selling insurance. The process of prior approval

\(^{263}\) There are different recommendations for the structure and function of a federal department of insurance, including that the federal authority should establish several regional offices and hear and resolve insurance-related conflicts between insurance providers and consumers. See Willy E. Rice, *Federal Courts and the Regulation of the Insurance Industry: An Empirical and Historical Analysis of Courts’ Ineffectual Attempts to Harmonize Federal Antitrust Arbitration and Insolvency Statutes with the McCarran-Ferguson Act-1941-1993*, 43 Cath. U.L. Rev. 399. (Winter, 1994), at VII. Conclusion.

\(^{264}\) See Waterfield, *supra* note 34, at 284.

\(^{265}\) See e.g. In Mississippi, the government sought to prevent State Farm Insurance Co., Mississippi’s largest homeowner insurer, from “refusing to write new homeowners and commercial policies” in response to State Farm’s disclosure that new homeowners and commercial policies were being suspending because of the “unstable” legal and political climate in the state. *Available at* http://www.msnbcmsn.com/id/17187629/.
itself takes time and incurs costs. Insurers also cannot use uniform rates and policies across the states. In addition, states sometimes restrict underwriting and risk classification.\textsuperscript{266} Insurance companies sometimes have to produce many different versions of their products at the same time, even when they are practically the same products, because of the different rate or policy regulations.\textsuperscript{267} At least in the short-term, introducing federal regulation will remove the redundancies of the multiple state regulations.

2. A federal regulatory system will increase innovation and international competitiveness

The state-by-state system causes insurance companies problems that directly affect the availability of coverage for clients. The unnecessary restraints imposed on insurance carriers by state regulation harm the clients as much as the insurers. This harm is caused when the regulations require time and incur costs for regulatory approval of policy forms in fifty-one different jurisdictions.\textsuperscript{268} Restrictions on insurer’s underwriting- (risk taking and selection) and risk-classification systems inhibit the availability of proper insurance products that would otherwise be available based on market principles.

\textsuperscript{266}See Jennifer Smith-Bozek, \textit{Regulatory Competition: A Primer} (Dec. 2007), Competitive Enterprise Institute, No 128, at 5 and n. 23. E.g., Geico, direct insurance company, did not sell insurance products in Massachusetts, which requires insurers to accept any applicants who request insurance.

\textsuperscript{267}Many states require prior rate approval, which takes time, incurs costs, and results in overlapping and a burden to the insurance providers.

\textsuperscript{268}See Albert, \textit{supra} note 98, at 13, e.g. An insurer sought to revise its coverage form and refiled the coverage forms in thirty-five states where the insurer had written policies for sixty-five insureds. After spending two years and $175,000, all thirty-five states approved the filings. However, when the forms were finally approved, they were useless because of outdated rates and form controls. The pre-approval procedure also leads to related direct costs, compliance costs, and delays.
Generally, the results of regulation stray from the market levels by creating comparatively low premium rates for high-risk insureds and higher premium rates for low-risk insureds.

The current local mode of operation cannot catch up with the globalization of business. State-based regulatory structures are not competitive enough to handle complex, sophisticated insurance trends and scope. Insurance regulators need to play a greater financial role to allow U.S. insurers to compete as rivals in the global financial markets. There is no federal agency to represent American domestic companies internationally, and foreign countries also demand that the U.S. government supervise domestic (U.S.) companies with care because the risk is related each other and the foreign investors put the money to U.S. financial institutions.\(^\text{269}\) Insurance has grown and expanded into national and international marketplaces, with risks spread across the country. By artificially restraining each state into an individual, secluded marketplace, state-based regulation constrains the capability of insurers to compete and thereby reduces the availability of insurance products. The multiple regulations cripple domestic insurers from expanding the market access they have to enter into markets by overcoming multiple huddles.\(^\text{270}\)

\(^{269}\) See e.g., OTS Receives EU Equivalency Designation for Supervision of AIG (February 23, 2007), available at www.accountability-central.com, The U.K. and French financial regulators have determined that the Office of Thrift Supervision (OTS) provides equivalent consolidated supervision for American International Group, Inc. (AIG) although the OTS regulates AIG under Section 10 of the Home Owners Loan Act (HOLA) instead of under the insurance department or the NAIC.

\(^{270}\) See e.g. State insurance supervisors tried to improve producer licensing by enacting uniform agent-and-broker licensure laws or reciprocal acts allowing an agent or broker licensed in one state to get licensed in all other reciprocal states by providing proof of licensure and paying a licensing fee. However, it was not done to reach true reciprocity and uniformity in all licensing jurisdictions. Most states retain a variety of individual requirements for licensing, and they all differ with respect to fees, fingerprinting, certifications, and continuing education. Albert, supra note 98, at 2.
1. States enjoy a regulatory monopoly and equally protect consumer rights

Each state government has a monopoly on insurance regulation within the state. States may worry that introducing a federal system would fail to produce innovation and would leave the state without motivation to innovate and reform regulations. Current state-based regulation does not capture the benefits of jurisdictional competition. An OFC could cure the defects of state-based supervisory systems and encourage jurisdictional competition between federal and state regulators, which would generate a more efficient regulatory structure. According to past experience, to reform bureaucracy and increase efficiency, it is better to deal with one federal regulator than to treat all fifty-one regulators individually. It’s difficult to anticipate the internal reform by each state, but some progress was made simply by Congress’s threats of federal intervention. Thus, the real reforms may be accelerated by competition, and meaningful change may be accomplished by external threats.

Because current state regulation cannot make the insurers provide equal products and lower prices, consumers are taking a loss indirectly. Consumers cannot receive their insurance products on time and at a proper price because of the regulatory inefficiency. Transparency requirements differ and conflict. For example, the disclosure requirements of insurance distributors (e.g. brokers and agents) about commissions and fees differ from

271 See supra note at 97, at 2.
272 See Albert, supra note 98, at 9. The NAIC leads the reform, but the reforms take too much time. Also, some of states still do not follow the model laws nor follow the uniformity in fact. See e.g. Florida and California, two of the largest states in terms of the volume of insurance premiums written, have not yet enacted the legislation from the NAIC Producer Licensing Model Act.
state to state, which causes clients to be confused when they receive different information and protection when they deal with insurance distributors from different state.

Current state regulatory systems provide uneven consumer protection from state to state. The states impose a lot of consumer-protecting rules to insurance companies regardless of where the insurers are chartered or based. The proposed federal regulation does not mean to weaken the influence of consumer groups or interests group because the small local consumer group cannot access federal regulator easy than state regulator. Some consumer groups may want to maintain the regulatory status quo; however, other more dynamic and uncontrollable consumer groups aggressively propose the strong federal regulation. Under a federal regulatory system that promotes judicial competition, the forces of the insurance industry\(^\text{273}\) and the influence of consumer groups can achieve a balance and an appropriate level of political influence. Under federal regulation, consumers can purchase policies from national insurance companies that provide the same protections and rights regardless of their domiciled states.\(^\text{274}\)

2. State-based regulation lacks consistency and foresight

Competition and efficiency in the insurance marketplace progress slowly compared to the other financial sectors because the state insurance regulatory system lacks consistency.\(^\text{275}\) The state-by-state regulation inherently possesses an inconsistent,

\(^{273}\) The power of lobby and lead of opinion for the insurance industry was influential from the past experience which hinder the revision of MFA or current state-based regulatory system.

\(^{274}\) See Albert, supra note 98, at 8.

\(^{275}\) State supervisory authorities have a tendency to suppress rates below the appropriate levels to satisfy consumers or interest groups.
duplicative, and often-times conflicting nature. Also, the interpretation and application of statutory language can be cumbersome and confusing. States also fall short of managing systemic risk because the states lack information, funds, and a specialty in the area. Another supporting argument for dual chartering is that to have a knowledgeable voice and advocate for insurance in Washington D.C., a federal insurance regulator is required.

3. The states cannot control systemic risks

There are opinions that the insurance industry, especially the retail insurance business, cannot cause systemic risk because insurance companies are not interconnected with the other financial services sectors and are not composed of a financial infrastructure, like banks. However, insurance companies in the recent financial crisis, such as AIG, were connected with banks, bond issuers, and consumers and did play a role in creating systemic risk. Insurance companies could not have avoided the financial turmoil or even survived without the help of the federal government. Because of an inability to spread or hold risks, the states currently cannot monitor or guarantee against many kinds of risks, including vast natural catastrophes and terrorism-related risks; the federal government must show up to prevent or solve the effects of systemic risks following big losses.

276 See e.g. Albert, supra note 98, at 5-6. State regulators still did not agree on the interpretation of the basic, critical terms of the NAIC’s Producer License Model Act enacted in state laws, even though the language of the provisions is identical.

277 See Webel, supra note 71, at 3.

278 See Federal oversee, supra note 92, at 3.
III. Anticompetitive licensing policy in Korea

A. Rules and procedures for licensing in Korea

1. Preliminary licensing for the insurance business in Korea

The regulation of the insurance industry in Korea can be divided into market regulation and operational regulation. The former includes market access, market exit, and mergers, but the latter embraces corporate operations, asset management, and marketing of the insurance industry. To access the insurance market, the insurer must get a license, which is the legal constraint to market access. To get a license in Korea, the company must specify the type of institution: subsidiary or branch to fulfill requirements. The “business of insurance” in Korea can be defined as the business of receiving money from the insured in return for promising payment of agreed benefits according to three types of insurance businesses. The three businesses are the life insurance business, the business of insurance against loss, and the third insurance business. Life insurance promises benefits for the insured’s life or death and insurance against lost indemnifies

279 Many foreign investors have made or plan to make sizable investments in the Korean insurance market, and this trend is expected to accelerate, especially due to the recent settlement of the Free Trade Agreement between Korea and the U.S. In addition, it is meaningful to study the insurance regulatory system of the U.S. in order to identify and improve any problematic issues in the Korean insurance industry, and vice versa.

280 The meaning of the business of insurance is defined in the IBA Article 2 (Definitions), Section 1. In Section 4 of the same article, the term “third insurance business” is defined to mean “the business of receiving money from the insured in return for promising the payment of agreed benefits to the insured for any disease, any injury and any nursing thereof or for indemnifying damage caused by such disease, such injury and such nursing for the insured.”
against damage resulting from any accident. However, the negotiation and the advertisement of insurance products can be a problem without having a license in Korea.281

Compared to establishing a branch office of a foreign insurance company, a Korean subsidiary is subject to stronger capital requirements and heavier supervision, such as quarterly business reports to the FSS.282

Under the Insurance Business Act (IBA), the process of obtaining an insurance business license from the FSC for a subsidiary or branch normally consists of three steps:

- acquiring a preliminary license,
- establishing a subsidiary/branch, and
- obtaining a formal license.

For foreign corporations to be eligible for a preliminary license, the following criteria must be met:

- the applicant must be a duly-licensed insurer and must engage in the same type of insurance business (i.e., life or non-life) in its home country;

281 See supra note 210. See also Regulation on Supervision of Insurance Business (of Korea) [hereinafter referred as “RSIB”] art. 1-6. (Insurance Contract Execution), “Foreign insurance companies may execute insurance contracts with the residents by postal mail, telephone, facsimile, and computer.” However, “[f]oreign insurance companies shall not consign, or delegate powers, to any insurance company, insurance solicitor, insurance agent, or insurance broker for the intermediation or representation for executing insurance contracts; provided that executing a reinsurance contract via an insurance broker shall be an exception.” And regarding advertising, RSIB art. 1-7. (Advertising) shows that “[f]oreign insurance companies may advertise insurance products by newspapers, television, radio, magazines, and computerized communication, etc. in the Republic of Korea.,” however, “when intending to advertise in accordance with the provisions of Paragraph (1), foreign insurance companies shall report to the Governor of the Financial Supervisory Service in advance by attaching the documents provided under certain items.”

282 See IBA, Article 9 (Capital or Fund) “(1) Every insurance company may commence its insurance business only after it makes a payment of not less than 30 billion won in capital or funds: Provided, That in the case that any insurance company intends to run part of the types of the insurance business ... within the amount of not less than 5 billion won.”; see also Enforcement Decree of IBA, Article 14 (Business Fund) “The business fund to be paid by foreign insurers ... shall be not less than three billion won.” (emphasis added).
• the applicant must have a sound financial status, evidenced by a certificate from a regulatory authority in its home country and a credit rating of at least investment grade from an internationally reputable credit-rating company;

• the applicant must not have been subject to a criminal fine or other heavier criminal punishment nor an institutional warning or other heavier administrative sanctions for the most recent three years;

• the applicant must bring operating funds\textsuperscript{283} that are not procured by loan;

• the company must have a compliance officer, an actuary, a claims adjuster, IT personnel, and other employees necessary for marketing, policy administration, claim handling, etc. (although outsourcing is permitted for the actuary and claims adjuster); and

• the company must have an office and IT facilities appropriate for its business.

2. Establishing a subsidiary or branch, and the review process

The application for a preliminary license must include documentation evidencing satisfaction of the above requirements and must include a three-year business plan, then the FSC and FSS will review the submitted documents and qualifications. A Korean translation should accompany documents prepared in a language other than Korean, and the FSS usually requests that such translations be notarized. Officials at the FSC and the FSS will review the application and may request additional documentation if deemed necessary. If the applicant meets the eligibility criteria, the FSC will issue a preliminary

\textsuperscript{283} See \textit{e.g.} A life-insurance subsidiary must have capital of at least KRW 30 billion while a branch requires KRW 3 billion.
insurance license to the applicant. Governmental review of the application and issuance of a preliminary license typically takes four to six months.

After receiving a preliminary license, the applicant is required to actually establish a subsidiary or branch in Korea. The process to establish a branch is as follows:

1. File a report of the branch's establishment with the Ministry of Strategy and Finance under the Foreign Exchange Transaction Regulation;
2. Register the establishment of the company with the court pursuant to the Korean Commercial Code;
3. Register the company with the tax office pursuant to the Corporate Income Tax Law and the Value Added Tax Law; and
4. Obtain operating funds for the company according to IBA requirements.

The company must prepare to begin business operations by securing office space, hiring necessary personnel, adopting and filing rules of employment, acquiring IT hardware and software, and adopting internal control regulations, etc. After completing the necessary preparation, the branch is eligible to apply to the FSC for a formal license. Certain documents must accompany the application, including evidence of a preliminary license, office lease, branch registration, evidence of the operating funds, terms and conditions of insurance, and calculation methods of premiums and reserves. Assuming that no substantial issues arise in the course of the FSC's review, a formal license may be issued within two to four months from the date of filing. Therefore, the entire process, from preparation of the application for a preliminary license to the grant of the formal license, may take less than one year to complete. The process may be delayed if the FSC or the FSS need more time to review the application.
B. The anticompetitive policy of licensing in Korea should be abolished

1. Controlling the number of companies makes the market inefficient

The Korean government, the FSC and FSS, control the number of insurance companies and the concentration of the market share by not allowing new licenses.284 This no-license policy or restriction is considered a discrestional act of the government; however, this discretion also has constitutional limitations based on its purpose, principles of equality, and principles of proportionality.285 The economic-needs test, which can limit market access to stabilize the insurance market, was abolished from the licensing process after Korea joined the Organisation of Economic Co-operation and Development (OECD), Korea officially denies having a policy that artificially manipulates market participants.286 However, there has, in fact, been practical restraints

284 From 1988 to 1997, thirty new insurers got licenses, but from 1998 to 2000 the number of newly established insurance companies decreased to three because many existing insurers liquidated and merged due to the Asian economic crisis. From 2001-2003, the number of new insurance companies increased to fourteen, but from 2004-2006, only one license was issued to a mono-line insurance company and only two licenses were issued to reinsurance companies for a total of three new licenses. And recently, from 2007-2009 only four companies got licenses in Korea; among them, two were mono-line insurers and two were reinsurers. KB life insurer was not counted because, practically, it was established as part of the existing Hanil life insurer. Actually, from 2004 on, FSC did not issue any licenses for comprehensive life or non-life insurance companies at all, and from 2009 on, no licenses were issued for insurers at all in Korea. See Annual Report of FSS (1999) - (2008).


286 The vice chairman of FSC recently announced a plan to continually restrict issuing licenses for comprehensive life and non-life insurance companies. See Edaily news, FSC “IBK Annuity insurer will be licensed” (Jan. 27, 2010), available at http://www.edaily.co.kr/News/Finance/NewsRead.asp?sub_cd=IC11&newsid=02000806592841984&cllcode=00203&DirCode=00402&OutLmkChk=Y.
and a declaration to arrange the number of insurance companies in the Korean insurance market.\textsuperscript{287}

This restraint of market access creates a lot of problems. First, the anti-market policy encourages inefficient market actions. An inefficient market diverts efforts away from constructive potential changes in the insurance industry.\textsuperscript{288} The insurance market would be more effective if inefficient, insolvent companies were abolished by efficient and solvent insurers. This process is the natural virtue of the business circle. If some degree of excess profit is guaranteed, an insurance business will not confront the risks for innovating or pioneering a new market but will maintain the status quo. Second, the entry restraints allow high cost and inefficient insurers to survive, losing the positive restructuring results of natural selection. Thus, the low-cost and efficient new applicants cannot access the insurance market. This trend will cause the quality of the insurance industry to decrease while also decreasing the insurance consumers’ welfare. Furthermore, the existing insurers can enjoy the high premiums in the M&A (merger and acquisition) market because entry denial leads to opportunities for M&A premiums that only existing insurance companies can capture.\textsuperscript{289} This policy makes efficient market restructuring by M&A more difficult because the price of M&A transactions is increasing.


\textsuperscript{288}FSC recently announced the decision to keep the policy of denying new licenses for comprehensive insurers. See Edaily news, FSC "IBK annuity insurer will be established" (Jan. 27, 2010), available at http://www.edaily.co.kr/News/Finance/NewsRead.asp?sub_cd=1C11&newsid=02000806592841984&clcode=00203&DirCode=00402&OutLnkChk=Y.

\textsuperscript{289}In Korea, AXA acquired Kyobo Auto Insurance Company, HSBC purchased 49 percent of Hana Life in 2007, Lotte purchased Daechan Fire & Marine Insurance, and Woori Finance Group purchased LIG Life Insurer in 2008..Recently, Consus Asset Management signed an agreement with Kumho Asiana Group to buy 13.29 percent of Kumho Life Insurance through Korea Development Bank (KDB). Based on these facts, the strategy to boom up M&A seemed to be successful in Korea.
In Korea, governmental policy encourages or compels investing in insurance companies through M&A rather than establishing new companies to enter the insurance market. In support of the government’s logic for boosting up M&A, it is sometimes cited that the biggest and strongest finance companies can serve the consumer better and contribute to social welfare fully. However, as shown by AIG and CITI Group, in reality, the biggest companies may not be the ultimate good; instead, huge companies can cause systemic risk and the morally hazardous notion of being “too big to fail.” There may be pros and cons of choosing the way to establish a company; however, the decision must be based on economic and voluntary decisions of the company. Thus, it is not recommended to set guidelines or governmental goals to encourage mergers and acquisitions by denying new insurance licenses in Korea.

2. Decrease of consumers’ profit and welfare

Restricting the number of companies can eliminate the possibility of price cutting by actual, effective competition. Competition among insurers can lead to price cutting of insurance products and enhance service quality, but an oligopolistic state causes a reduction in or diminution of benefits that rightfully belong to consumers. In other words, if a government fails to encourage new entry and facilitate easy market access, it can lead to hesitations to develop new products, poor quality of insurance service, and a lack of

290 This fact is informally known, but the government did reveal the policy through the press. See Asia Today News, The Establishment of New Insurers will Increase (Jan. 25, 2010), available at http://www.asiatoday.co.kr/news/view.asp?seq=321712.
innovation to the insurance industry. These results, then, have direct and indirect negative effects on consumers.

3. The excess profits go to existing insurers

The entry denial policy transfers excess profits from consumers to existing insurers. Market competition would cause the profit to go to insurance consumers, but it passes to the existing companies instead. Also, in Korea, the life insurance companies can enjoy the excess profit by initial public offerings (hereinafter referred to as “IPOs”). The profit gained through the IPOs transfers to life insurance company shareholders. The government promotes or allows the shareholders to receive enormous profits that should belong to the insurance consumers. Therefore, the entrance-denial policy must be discarded or revised to enable fair, liberal competition in the insurance market. These reforms may also rightfully return the excessive profits to the consumer.291

4. Constitutional challenges to controlling market access

a. Due Process issues

Applicants who want to start new insurance businesses cannot choose the way to establish their companies or access the insurance market without specific explanations...

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291 Tong Yang Life Insurance Company listed on stock market through initial public offerings in 2009 and recently Korea Life, the second largest life insurer, also listed on the stock market. Samsung Life, the first and largest insurer in Korea will list on the stock market through IPOs with stock value that will be increased from a par value of KRW 5,000 to KRW 1.2 million; and the controlling shareholder, Kunhee Lee, the president of Samsung group; will get the largest benefits from the IPOs. Kyobo Life and Mirae Asset Life also will follow the precedent.
and hearings. Although it appears to be a matter of a constitutional right to protection against unreasonable licensing requirements and rejections, in Korea, applicants have no actual, proper Due Process right when they are establishing a company and are denied access to the market. Therefore, there is no actual procedure to appeal the licensing denial, and there have been no applicable cases in Korean courts. Taking a lawsuit against the government or a governor may lead to some type of revenge as a result of the suit, such as the establishment of a strict scrutiny standard in ongoing supervision or other approving and licensing rejections. The government must stop retaliatory administrative action against entities who sue regulators in the interest of securing their rights of Due Process. Also, if a potential entrant is denied, the applicant must wait a significant amount of time before being allowed further chances for licensing. However, the right to reapply must be given without any prejudice. If the government tries to secure positions for specific companies, such as a domestic company or existing company, there could be Commerce Clause or substantive Due Process issues.

b. Abuse of discretionary power

The regulator cannot develop an effective market or fully enhance the consumer's benefits by operating such a limited number of companies and securing profits only to the

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292 One may start business as a distributing channel—as a broker, an agent, or a solicitor—but the issues dealt with in this dissertation concern insurance companies.

293 For example, the regulator can apply the strict scrutiny standard to the examination and the sanction.

294 The discrimination or burden to commerce can be found in a similar case, See C & A Carbone, Inc. v. Town of Clarkstown, 511 U.S. 383 (1994).
existing companies. The requirements and theoretical need justifying the regulations to market access are explained in that the insurance industry is not fit for total competition because of the need to achieve a level of prudence in the insurance companies and to improve the consumers' welfare. However, that need depends on the market mechanism and on fair competition. If a regulator tried to control the maximum market utility, the regulator is attempting to control economics, like a socialist state.

Applicants have to wait for governmental permission even when they are qualified to be admitted to the market. Sometimes, because the governor anticipates rejection in Korea and then exercises his or her discretion, the applicant cannot even submit an application. The government has the authority and power to permit new insurance businesses; however, there must be a limitation or a legal standard to temper the government's power. There is a latent limitation to the governmental discretion to issue licenses and to request reviews of the qualifications: the regulator must disclose all the required elements in advance and must refrain from further requests for additional undisclosed requirements that might postpone the process.

There may be opinions that the purpose of licensing is preventing disqualified applicants from gaining market access; it is risky to expect that certain insurers can succeed in the market in the future if they ignore the prepared rules and procedures for entering the market. Licenses can be given with certain provisions; however, the abandonment of constitutional rights cannot be the provision. It cannot be forbidden to

295 The requirements for insurance entry include the legal formation (e.g. corporation or mutual company) and a minimum capital requirement for admission to the business of insurance.

operate certain types of insurance business. There are some cases where licenses in Korea are given with provisions. For example, when Genworth, a mortgage insurance company, obtained its mortgage license, there were geographical and product restrictions. These restrictions are not considered abuses of discretionary power.

5. Restrictions on market access are against global standards

The International Association of Insurance Supervisors (hereinafter referred to as “IAIS”) was established in 1994 and represents insurance regulators and supervisors of around 190 jurisdictions. The IAIS publishes papers on global insurance principles, standards, and guidance. Also, to promote financial stability, IAIS gives training to and holds international meetings and seminars for insurance supervisors. Under IAIS principles, licensing is very important to ensure efficient, stable insurance markets. Strict standards of formal governmental approval may be necessary to protect insurance users but also may be needed to help ensure that fair competition exists among companies in the market. The IAIS suggests that general licensing principles, licensing requirements, licensing procedures, and a system for withdrawal of licenses must be applied in every regulatory regime.

297 See http://www.iaisweb.org/index.cfm?pageID=28, IAIS also has more than 120 “observers” representing industry associations, professional associations, insurers and reinsurers, consultants, and international financial institutions. The IAIS issues global insurance principles, standards and guidance papers, provides training and support on issues related to insurance supervision, and organizes meetings and seminars for insurance supervisors.

298 See Report from the IAIS Technical Committee, Supervisory Standard on Licensing (September 28, 1998). This report contains the IAIS’s general licensing principles, licensing requirements, licensing procedures, and system for withdrawal of licenses.
The types of companies that must be licensed may be divided into domestic insurers and foreign insurers, and foreign insurers may operate either by a local branch or on a services basis. Documents containing information must be provided to the host supervisor which supervises the applicant’s head office; in detail, the information should include the name and address of the place of incorporation, the type of insurance product offered, confirmation of the solvency of the company, and descriptions of any violation of regulatory requirements in the company’s home country. The country must classify the types and classes of insurance (at least into life and non-life) and give appropriate licenses according to domestic law where the insurer applying to. A license basically must be given for an unlimited period, except with a periodic-renewal-requirement provision.\textsuperscript{299} Although the standards and recommendations of the IAIS make no express prohibition against restraining licensing, it can be easily inferred that it is an abuse of discretionary power to control the market according to anticompetitive policies.\textsuperscript{300}

C. Recommendation of competitive policy

Under the regulatory process, applicants must observe and fulfill the requirements for establishing an insurance company: type of business, business plan, suitability of owner, affiliation contracts and outsourcing, product and rate control, licensing procedure, etc. However, the effect of the licensing policy is stronger than the strict requirements for licenses, especially the no-licensing policy. The decision to access market should be done

\textsuperscript{299} IAIS Standards, at 5, 8.

\textsuperscript{300} The barriers to entry must be removed or lowered according to the WTO structure.
by the applicant or insurer and not by a regulator, although regulators maintain the power to review and the reasonable discretion to judge. The resulting obstacle to market access propels inefficient market mechanisms and funnels excessive profits to existing insurers and shareholders. The government must stop giving a governmental subsidy or additional market share to existing participants (insurance companies) and hurting consumer welfare by taking away the consumers’ potential profits.

In these days, policies of competition lead to a more effective market than manipulation of the market by government intervention does. Exceptional situations may require government intervention, particularly in cases of “market failure” where the market mechanism cannot deliver the desired level or allocation of benefits to consumers.301 Thus, the regulator must encourage market competition by allowing new market participants to enter and motivate the existing insurers to improve their performance. The government does not have to use its licensing authority to limit the number of insurance companies as a way to enhance M&A; M&A may ruin “market discipline.”302 Instead, for market stability, the regulator should maintain the licensing standard, adjust the liquidation standard, and promote the standard of prudence, including the solvency-margin ratio.

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302 The financial institutions, including insurance companies, conduct business while considering the risks to their stakeholders. “Market discipline is a market-based promotion of the transparency and disclosure of the risks associated with a business or entity.” It works in concert with the regulatory regime to increase the safety and soundness of the market by market participants’ monitoring and responding through disclosure, price of stock and bonds, etc. available at http://www.investopedia.com/terms/m/market-discipline.asp.
Chapter 5: Symbiotic Approach to Reforming the Antitrust Exemptions

The federal antitrust laws were enacted to promote consumer welfare by increasing output and lowering prices, thereby increasing efficiency and effecting proper distribution. The insurance exemption to U.S. federal antitrust law is a doctrine that attempts to balance the need for competition and the need for an exchange of information to allow insurers to give better services.  

The first issue is how to balance the need for competition and the need to keep the exemption to promote consumer welfare. Effective antitrust enforcement and information sharing among rivals may serve the consumer welfare together, and the scope and application of the exemption should be determined by the extent that the exemption enhances consumer welfare. The second issue is the allocation of competition enforcing power between the federal and state authorities; this issue is related to federalism and the U.S. political system.

I. Federal antitrust law and insurance exemption

A. Antitrust statutes and application to the insurance industry

Two of the purposes of federal antitrust laws are ensuring and protecting competition or the competition process, and success in these efforts is achieved by

303 See Farmer, supra note 74, at 143.
304 See Id., at 143.
305 Id.
improving economic welfare. The antitrust laws reflect the belief that competition in the business marketplace strengthens consumer welfare and enhances social, economic, and political freedom. To pursue this purpose, from 1890 to 1914, Congress enacted the Sherman Act, the Clayton Act, and the Federal Trade Commission Act.

The Sherman Act made contracts, combinations, and conspiracies that restrain interstate or foreign commerce as well as monopolies or attempts to monopolize interstate or foreign trade illegal under certain conditions. However, unrestricted competition may be inconsistent with other important public policies or regulatory goals that also serve the social interest. Thus, some conduct must be exempted to satisfy necessity and serve specific purposes.

The Clayton Act declared that price discrimination, exclusive dealings arrangements, corporate mergers, and interlocking directorates are illegal under certain circumstances. With the intention to create the McCarran exemption, Congress probably did not intend the antitrust exemption to apply to insurance mergers; the U.S. Supreme Court confirmed Congress’ lack of intention. The applicable state insurance laws wanted to guard shareholders’ profits rather than policyholders’ interests and, therefore, did not constitute regulations of the business of insurance. Federal law enforcement also investigates insurance company mergers with the view that the McCarran exemption is

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306 See Emch, supra note 301, at 186.
307 See supra note 97, at 2.
308 See GAO, Exemption, supra note 55, at 3.
not valid in cases of merger. The Federal Trade Commission Act (hereinafter referred to as “FTC Act”) created the Federal Trade Commission (hereinafter referred to as “FTC”) and empowered it to enforce aspects of the antitrust laws and prohibit unfair methods of competition and unfair or deceptive acts affecting commerce.

1. General application of antitrust laws

The Sherman Act makes contracts, combinations, and conspiracies that restrain interstate or foreign commerce illegal. Under certain circumstances, it also bans monopolies or attempts to monopolize interstate or foreign commerce. The Sherman Act’s § 1 inhibits “horizontal” or “vertical” acts or practices that restrain competition. “Horizontal” restraints are agreements among competitors and include cartels and agreements to exclude competitors. Vertical restraints are agreements between sellers and buyers and embrace resale price maintenance, territorial or reciprocal dealing restrictions, and tying arrangements. Horizontal agreements include explicit agreements as well as implicit understandings. Although an agreement may be verified by indirect evidence,

311 Supra note 64, at 134.
312 Supra note 64, at 6.
313 The Sherman Act’s provision in Section 1 only broadly distinguishes which contracts are prohibited, because any contract has tendencies to restrain trade; however, the European Union’s Article 81 prohibits contracts that may “prevent, restrict, or distort competition” with an exemption if the contracts contribute to improving the production or allocation of goods or promote technical or economic progress, “while allowing consumers a far share of the resulting benefit.” See Emch, supra note 301, at 185.
314 See Exemption, supra note 55, at 2.
315 See supra note 64, at 8. Such acts or practices are also prohibited by the FTC Act in Section 5 as “unfair methods of competition” 15 U.S.C. §45.
316 See GAO, Exemption; supra note 55, at 3, n.7.
unlawful conspiracies cannot be inferred from mere parallel conduct. 317 Although some horizontal agreements may increase consumer welfare and competition, all agreements among rivals create a latent risk of violating antitrust laws. Agreements among rivals are conclusively presumed to be unlawful, based on a per se rule. 318 Agreements having unclear anticompetitive effects are viewed under a “rule of reason,” which requires a factual and flexible inquest to decide whether the challenged act or practice has unreasonable, comprehensive anticompetitive effects in the pertinent market. 319

2. Per se illegal and the rule of reason

By the time the McCarran exemption was established in 1945, the U.S. Supreme Court had adopted per se rules in several areas, eliciting debate about horizontal price fixing and vertical resale-price maintenance. 320 Broadcast Music Inc. v. Columbia Broadcasting System Inc., 321 and Arizona v. Maricopa County Medical Society 322 are among the leading cases on this issue. However, modern antitrust analysis has evolved since the court rigidly applied the per se rules to the original categories. 323 The developing category of exceptions included technical horizontal price-fixing agreements

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320 Farmer, supra note 74, at 146.
323 See Farmer, supra note 74, at 147.
that efficiently established a new product ordered by customers\textsuperscript{324} and data dissemination if a third party collects data that contains historical prices with a precompetitive purpose for the exchange.\textsuperscript{325}

Price fixing is an agreement among competitors to set the product price. Such agreements to fix maximum and minimum prices are forbidden.\textsuperscript{326} Gender, age, and physical competitiveness can be bases for risk and subsequently for the price of insurance products. Discrimination charges may be challenged, and the practice may be allowed so that the insurer can calculate the exact risks and appropriate prices. The exchange of price among competitors can reduce the range of prices and promote competition. Thus, it is usually presumed to create a cartel.\textsuperscript{327} Also at issue is the question of who has the burden of proof. In price-fixing cases, the defendant usually bears the burden of proving the defense that the anticompetitive conduct results in effectiveness. When identical insurance products are bidding, the same bidding-price problems can arise, with respect to competition, even without the conspiracy.

A price-fixing agreement, market or customer division, and group boycotts are lead to the application of the per se rule.\textsuperscript{328} Price fixing includes agreements on sales prices, setting a substance of price or fixing any terms and conditions of the sale that

\textsuperscript{324} Supra note 316.


\textsuperscript{326} See supra note 64, at 10.


\textsuperscript{328} A price-fixing agreement is any arrangement among rivals that has the intention or effect of prohibiting price competition. See Dianne E. Pierson, Antitrust Analysis in Uncertain Times: FTC v. Superior Court Trial Lawyers Association, 24 Creighton L. Rev. 125 (1990).
affect price competition.\textsuperscript{329} Under the per se rule, arrangements among competing insurers on end rates or on meaningful components of the rates, such as the probable-loss cost or the expense elements, might be unlawful price fixing without an exemption. In addition, it would also be deemed unlawful price fixing for insurers to standardize the coverage terms if rates are significantly affected.\textsuperscript{330}

A boycott is an agreement among rivals not to deal with a certain person or firm; boycotting is illegal if used to deal with competitors or third parties. Boycotts to prevent a business from accessing a market or to disadvantage a rival violate antitrust law, too. A boycott may also be illegal when it influences price competition without a reasonable excuse or exemption.\textsuperscript{331} Some boycotts in the insurance industry would be per se illegal, without an exemption, if an arrangement was made in the following manners:\textsuperscript{332}

- among rating-agency members not to employ independent agents of non-member insurance companies that refuse to use agency rates;
- by members of a rating institution to oust insurance companies that decline to accept the instituted rate; and
- by insurance companies to leave the market to get policyholders' consent for higher rates.

Group boycotts are concerted by competitors and suggested to rivals or customers. However, many agreements not to deal with others are legitimate because they are crucial

\textsuperscript{329} See ABA ANTITRUST, \textit{supra} note 64, at 10.

\textsuperscript{330} See ABA ANTITRUST, \textit{supra} note 64, at 11. However, a joint purchasing agreement or joint venture may fall under the rule of reason.


\textsuperscript{332} See ABA ANTITRUST, \textit{supra} note 64, at 12.
to the conduct of the businesses involved. Thus, there can be lawful boycotts, such as boycotts involved in the process of selective risk undertaking.

Tying agreements are illegal per se, if they relate to two distinct products, the seller is forcing the sale of both products, the seller has enough economic power in the market to succeed, and the tied products can affect the trade sufficiently. In the insurance context, if an insurance company refuses to sell a specific policy without the purchase of a noninsurance product or vice versa, the action is illegal per se. For instance, it may be illegal tying if an insurer refuses to make a loan unless the customer also buys insurance. Illegal boycotting may also exist when an insurance carrier declines to sell a certain type of coverage separately, or without the customer buying a package: an insurer only sells cancer coverage if the purchaser buys term life insurance.333

Some restrictive agreements among rivals fall under the rule of reason because the agreements may produce precompetitive results by introducing new products or increasing performance efficiency.334 For instance, the joint underwriting pools or syndicates are necessary to bear enormous risk or to prevent market failure as bona fide joint ventures.335 Other horizontal agreements can be evaluated under the rule of reason. For example, self-regulation or standardization of policies may be done by an insurance industry association for efficiency and consumer welfare. Self-regulation or standardization of policies is an agreement among competitors allocating the territory or customers to restrict output. However, similar agreements that are only ancillary to

333 See ABA ANTITRUST, supra note 64, at 16.
334 Id., at 12.
335 See id, at 13.
cooperative, productive activity and reasonably necessary joint ventures may be subject to the rule of reason.\footnote{Robert H. Bork, \textit{The Antitrust Paradox} (1993).} 

B. Exemption rules applicable to insurance

Many of the ratemaking and statistical functions done in the insurance industry would violate the Sherman Act, without an exemption. The exemptions can be classified by the Antitrust Act’s three categories:\footnote{Farmer, \textit{supra} note 74, at 143-144.}

- The general exemptions and immunities exist to shield another important public policy. For example, the statutory exemptions for labor organization and export associations to further national policy.

- The industry specific exemptions to protect joint conduct that otherwise might be subject to an antitrust challenge. For example, the MFA was provided for insurance industry. Some people demand the application of the general principle that the exemptions are disfavored. The exemptions also must be narrowly tailored to attain an imperative public aim or to make a regulatory plan work; and

- There are non-statutory exemptions and defenses which include judicially created or implied exemptions and defenses created to avoid conflict with federalism or authority. For example, state action immunity, \textit{Noerr-Pennington} immunity, and implied immunity.

\footnote{Farmer, \textit{supra} note 74, at 143-144.}
1. The MFA as containing an industry specific exemption

As one commentator has noted, there were many antitrust issues in the property and casualty insurance industry in the 19th century. The state started to tax and regulate the insurance industry by focusing on solvency. Before major fires occurred, many fire insurers had profits and could compete by lower the prices. At that time the independent agents usually sold fire insurance policies, providing cheap insurance products due to competition and selling the insurance policies to bad-risk bearers. However, competition and lower prices resulted in serious threats to the insurers' solvency and caused bankruptcy. As a result, the insurance companies started to set agent commissions collectively and to make a pool for gathering loss-experience data to protect themselves. This cooperation was especially beneficial to small- and medium-sized insurance companies, which had difficulty amassing loss-experience data by themselves.

As mentioned above, the U.S. Supreme Court affirmed in *Paul* that insurance was not commerce and the power to tax and regulate it remained with the states. In 1942, however, the state of Missouri indicted the South-Eastern Underwriters Association and its membership of nearly 200 private fire insurers, along with 27 other individuals, for alleged violations of the Sherman Act. The indicted were charged with restraining interstate trade and commerce in several states by fixing and maintaining arbitrary and

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339 See Chapter 2, I.

340 The parties were prosecuted for violating federal antitrust law at the behest of the Missouri Attorney General.
noncompetitive premium rates on fire and other lines of insurance. They were also alleged to have violated the Sherman Act § 2, by monopolizing trade and commerce.\textsuperscript{341} The U.S. Supreme Court finally overruled \textit{Paul} and found that the federal government had jurisdiction over insurers because insurance was "interstate commerce" which Congress could regulate under the Commerce Clause.\textsuperscript{342} This decision elicited great concern whether insurance companies could continue to work together in ratemaking and taxing and regulating the insurance industry.\textsuperscript{343} Congress decided to enact to the McCarran-Ferguson Act to grant a limited but absolute exemption from federal antitrust liability if the situation met three conditions:\textsuperscript{344}

- The conduct must be the "business of insurance";
- It must be "regulated" by the state law; and
- It must not constitute "boycott, coercion, or intimidation."

2. Judicially created immunity

a. State action immunity

Antitrust laws do not regulate state action or official action directed by a state.\textsuperscript{345} State action-immunity was first introduced by the case of \textit{Parker v. Brown},\textsuperscript{346} where the

\textsuperscript{341} See RANDALL, \textit{supra} note 22, at 633.

\textsuperscript{342} \textit{SEUA}, 322 U.S. 533 (1944).

\textsuperscript{343} See Bauer, \textit{supra} note 54, at 121.

\textsuperscript{344} See 15 U.S.C. §1011-1015. See also Farmer, \textit{supra} note 74, at 146.

\textsuperscript{345} The McCarran-Ferguson Act contains a statutory insurance exemption, but the effect is similar to the effect of a state action exemption. The difference between a statutory exemption and a state action exemption is that the former contains an "active state supervision" requirement while the latter does not.
concept of federalism was implemented in upholding a state statute that supported the program of price fixing and restraining output among raisin farmers.\textsuperscript{347} To meet the standards of state-action immunity, the conduct of private actors must satisfy a two-pronged test. The test requires that the challenged conduct must be pursuant to "clearly articulated" and affirmatively declared state policy and must be "actively supervised" by the state.\textsuperscript{348}

To satisfy the clear-articulation standard, the state must clearly intend to replace competition in a specific field with a regulatory structure; the state's intent to establish an anticompetitive regulatory program must be clear and must permit rather than compel joint action.\textsuperscript{349} After the state has expressed a policy to suppress all conduct that may be considered to bring about authorized consequences, unless the state institutes the policy because of a conspiracy among the officials or because a private party forces the state officials to act.\textsuperscript{350}

The active supervision requirement is satisfied where the state regulators have the statutory authority to inspect and where the authority of the state regulator is actually exercised.\textsuperscript{351} However, the active supervision is not merely having the statutory authority

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\textsuperscript{346} 317 U.S. 341 (1943).


\textsuperscript{348} \textit{California Retail Liquor Dealers Ass'n v. Medical Aluminum}, 445 U.S. 97 (1980).


\textsuperscript{350} \textit{Sandy River Nursing Care Ctr. v Aetna Cas. & Sur. Co.}, 985 F.2d 1138, 1143-45 (1st Cir. 1993).

\textsuperscript{351} See \textit{Southern Motor}, supra note 349, at 61-62.
to review; the mere potential for review is not an adequate substitute for an actual review by the state.\textsuperscript{352} Evidence that the insurance department was “staffed and funded” and that it showed “some basic level of activity” in executing the rating law is not sufficient for active supervision either.\textsuperscript{353} Thus the mere theoretical possibility of review or playing a passive role without actual checks on the challenged private conduct is not enough to be active supervision.\textsuperscript{354} In the insurance practice, a situation where the state reviews the insurer’s practices through a formal administrative hearing, which is not discretionary under a state statute, may meet the active-supervision requirement.\textsuperscript{355} However, the situation is not certain to meet the active-supervision standard when the state reviews insurers’ conduct internally, non-publically, or without any review at all because the courts definitely require a factual and intensive review. Thus, it is difficult to foretell the availability of state action immunity in advance of the state’s internal review.\textsuperscript{356}

b. \textit{Noerr-Pennington} Doctrine

Known as the “\textit{Noerr-Pennington} doctrine,” this immunity makes antitrust laws inapplicable to individual or group action intended to affect legislative, administrative, or judicial decision-making, if this action is prompted by the joint lobbying or joint litigation efforts of competitors and on the condition that such action is not a just sham to


\textsuperscript{355} Snake Valley Elec. Ass’n v. Pacific Corp., 357 F.2d 1042, 1049-51 (9th Cir. 2004).

\textsuperscript{356} See ABA ANTITRUST, supra note 64, at 34.
hide what is in actuality nothing more than a baseless suppression.\textsuperscript{357} The \textit{Noerr} doctrine is especially important to insurance industry trade associations and professional societies. The purpose of these groups may be lobbying and advocacy in representation of the interests of the insurance industry in regards to legislation, administration, and judicial proceedings as well as other activities related to governmental decision making such as surveys, reports, standard setting, and preparation of codes of ethics and professional discipline.\textsuperscript{358} Without immunity, including the Noerr immunity if an activity is influencing a governmental decision, the above activities would be subject to antitrust laws. The \textit{Noerr} immunity is based on the First Amendment right to petition the government. It is judicially recognized that the government’s anticompetitive action is not subject to antitrust laws, even if the government was persuaded to act by private parties, because the antitrust laws were enacted to regulate business activity rather than political activity.\textsuperscript{359}

\textit{Noerr} immunity applies to efforts made by insurance companies through their trade associations and to other efforts to restrict or suppress competition, such as laws forbidding banks from expanding their sales of insurance lines. The efforts can be made through direct contact or indirect influence, like grassroots lobbying and campaign funding. Insurers and their trade associations can be involved in judicial proceedings as parties, interveners, or amici curiae. The \textit{Noerr} doctrine would apply where members of the insurance industry sue by jointly opposing the administrative approval of a

\textsuperscript{357} See Holmes, \textit{supra} note 354, at 813.

\textsuperscript{358} See \textit{supra} note 64, at 119.

\textsuperscript{359} See ABA ANTITRUST SECTION MONOGRAPH No.19, \textit{The Noerr-Pennington Doctrine} (1993).
competitor’s market access, even if done with anticompetitive intention. But the Noerr immunity will be inapplicable if insurance companies cause direct damage to competition through the proposed legislation, such as threatening to withdraw from the market by anticompetitive agreements by competing insurance carriers. Noerr also does not immunize the exchange of anticompetitive information or data among trade association members, even if they intend the exchange as lobbying efforts, because it might be considered a tool to facilitate agreements that restrain competition and have nothing to do with petition rights. The Noerr doctrine applies to efforts influencing executive action, such as the action of state insurance departments or other executive agencies, as long as any damage or injury that results is caused by governmental action. Therefore, because the NAIC is not a government party, the Noerr immunity does not extend to the efforts to secure or prevent action by the NAIC.

c. Implied immunity, filed-rate doctrine

Through principles of exclusive or primary jurisdiction, the federal Keogh doctrine, and the filed-rate doctrine, a regulated firm can apply for permission from a regulatory agency to take certain action. Those exclusionary principles are similar in

360 See ABA ANTITRUST, supra note 64, at 38.
361 See ABA ANTITRUST, supra note 64, at 124.
362 See ABA ANTITRUST, supra note 64, at 125.
364 Michael K Kellogg, Aaron M. Panner, Comments on The Filed Rate Doctrine (2005), at 1-2, available at http://govinfo.library.unt.edu/amc/public_studies_fr28902/immunities_exemptions_pdf/050715_USTelecom.pdf. It is also called the filed tariff doctrine. The entity which is required to file to file rates, terms and conditions of service government can be barred any antitrust claim for damages as collateral attack.
certain ways, but technically distinct. The *Keogh* doctrine originated from *Keogh v. Chicago & Northwestern Railway*, a case where the U.S. Supreme Court prohibited recovery of antitrust damages for an asserted conspiracy to fix rates because the rates were filed with and approved by the Interstate Commerce Commission. The court denied rate-related damages awards that might conflict with the agency’s determination of what constitutes a reasonable rate. However, the *Keogh* doctrine does not preclude injunctive or other equitable relief. The *Keogh* doctrine has applied as a defense to insurance-rate charges in state and in federal antitrust actions.

Where administrative agencies like a state insurance department has exclusive or primary jurisdiction, the agency has sole authority to resolve disputes regarding the regulated conduct. To determine if an agency’s jurisdiction is exclusive, a court usually examines the following factors:

- if application of the antitrust laws could conflict or otherwise disrupt the regulatory plan;
- if the plaintiff’s claim might result in a challenge of the regulatory decision or regulated conduct;
- if the claim is associated with a regulator’s policy discretion; and
- if the plaintiff has a proper administrative remedy.

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365 250 U.S. 156 (1922).

366 *Id.* at 163; see also *Square D Co. v. Niagara Frontier Tariff Bureau*, 476 U.S. 409, 411 (1986).


368 See ABA ANTITRUST, supra note 64, at 39.

369 See ABA ANTITRUST, supra note 64, n.174 at 39.
Sometimes a court recognizes concurrent jurisdiction and applies the primary jurisdiction if the administrative remedy is improper; the court may also permit the plaintiff to pursue antitrust remedies that are different from the agency’s scheme.

II. The movement to repeal the McCarran-Ferguson Act is improper

The decision of whether or not to repeal or revise the McCarran insurance exemption is determined by whether or not an industry-specific immunity for the business of insurance is still necessary. 370

A. Support for repealing the MFA antitrust exemption for insurers

Recently, there have been movements to reduce the scope of or repeal the McCarran-Ferguson Act’s insurance exemption. 371 A lot of legislative proposals introduced by Congress and the Senate, such as House Bill 2401, Senate Bill 1525, and Senate Bill 2509, include provisions eliminating the McCarran exemption and prohibiting medical malpractice insurers’ price fixing, bid-rigging or market allocation, and authorization of federal regulation for insurers who opt into the federal program. 372 These

370 See Farmer, supra note 74, at 148.


372 See supra note 5, at 1.
propose reforms may increase insurers' antitrust exposure, even though insurance is heavily regulated by state law. The arguments to repeal the MFA are put forth as follows:

- the environment has changed;
- the repeal will make the insurance industry competitive;
- the repeal will have no serious impact on the insurance industry;
- the federal courts need education and experience; and
- there is no reason to treat the insurance industry specially.

3. The environment has changed

The situation and environment have changed from the time when the MFA was enacted. The MFA was enacted when Congress thought the principal regulators should be the states. However, the federal role in regulating insurance and the need for federal regulation in the insurance industry are increasing, especially in the antitrust fields. The MFA is used to protect effective antitrust application from the anticompetitive restraints, particularly when the antitrust actions are different than Congress anticipated when enacting the antitrust laws.373 For example, horizontal agreements like policy-form standardization and price fixing can possibly increase competition. The full application of federal antitrust laws to the insurance industry will strengthen both state and especially federal enforcements.

Some consumer groups believe that the insurance rating bureau, such as the Insurance Service Office, which is used by many insurers as the basis for insurance

ratings, conducted cartel-like activity in the U.S. It is also contended that insurance rating organizations manipulate data and project pricing into the future, which may be illegal without the McCarran immunity; it is also believed that these organizations raise insurance rates unnecessarily and collusively. The consumer groups also estimate that if the McCarran exemption is repealed, approximately 10 percent or $45 billion a year will be saved by competing among insurers. 374

4. The repeal will make insurance competitive: from California’s reforms

Repealing the McCarran exemption will increase competition in and benefit the insurance industry. The California reforms give a good example of how competition reduced the cost for consumers over time. 375 Proposition 103 changed the application of antitrust laws from a situation that allowed cartel-like rating to a situation with tough restrictions and regulations that encourage competition. 376 The restrictions require that insurers must have prior approval of insurance rates and forms, which eventually leads to lower rates than the national average. One of the regulations concerns selling insurance at


375 The following arguments that support the repeal of the McCarran exemption are mostly based on the “Questions and Answers” from “Supplemental Submission to the Judiciary Committee On behalf of the office of the Attorney General of the State of New York”, See supra note 5, at 30-31.

376 Proposition 103 (e.g., Section 1861.01 of the California Insurance Code) was passed by voters to demand that every insurance company diminish its rates to at least 20% less than the California rates in 1987, unless such a rollback would cause the insurer to be insolvent. Before passing Proposition 103 on November 8, 1988, the California Department of Insurance ran under the McBride-Grunsky Insurance Regulatory Act, which did not require insurers to file rates for approval except for health and life insurance. Since 1989, the Rate Regulation Division has been accountable for negotiating with insurance carriers to meet their rollback duty. The Rate Regulation Division reviewed underwriting for compliance with regulation and processed 7,700 filings in 2002. See About us: Provisions of Proposition 103s affecting the rate regulation division, California Department of Insurance, available at http://www.insurance.ca.gov/0500-about-us/0500-organization/0400-rate-regulation/prop-103.cfm.
banks; agents are allowed to offer rate rebates, but excessive expenses, fines, bad-faith lawsuit costs, and excessive executive salary costs are disallowed. Proposition 103 rejected the “cost-plus” system, which adds up anticipated loss and expenses as costs, and then includes profits on top of those costs instead of choosing costs tested by efficient state standards.\(^\text{377}\) California also disallowed excessive costs, such as extreme expenses, fines, bad-faith lawsuit costs, and excessive executive salary costs.\(^\text{378}\) Strong incentives for drivers themselves to reduce the cost of insurance motivate insurers to offer discounts for driver-safety, such as offering a twenty percent discount to customers who have clean driving records. Repeals of the insurance exemption were implemented, which prohibit price fixing and sharing data, including sharing the price, marketing and advisory information, generic expenses, and profits.\(^\text{379}\) When Proposition 103 passed, California had the third highest auto insurance rates in the U.S., but then the rates lowered to be the twentieth highest, then lowered to around the average national rate in 2006. The reduction totaled approximately twenty percent, compared to the national average, which saves consumers tens of billions of dollars.\(^\text{380}\) Based on the NAIC statistics from 1989 to 2003, the average automobile insurance rate rose by 9.8 percent in California, but the national average rose by 48.7 percent.\(^\text{381}\)

\(^{377}\) The California Supreme Court upheld Proposition 103, which mandated a 20 percent rate cut in property-liability insurance in May 1989. The result showed that Proposition 103 brought an unfavorable result for insurers in the capital market and significantly negative and abnormal returns for some insurers. See Samuel H. Szewczyk and Raj Varma, the Effect of Proposition 103 on Insurers: Evidence from the Capital Market, the Journal of Risk and Insurance, Vol. 57, No.4 (Dec., 1990), at 671, 679.

\(^{378}\) See Hunter, supra note 369, at 30.


\(^{380}\) See Hunter, supra note 369, at 23.

\(^{381}\) See Hunter, supra note 369, at 89.
However, these achievements seem to result from the restriction of rates with strict prior approval by the state of California rather than by competition among insurers and market efficiency in applying federal insurance antitrust laws. The research showed that the result of the lowered rates was not because of strengthened state regulatory scrutiny or removing the McCarran exemption for the insurance industry, but because of reduced loss costs in California due to several other factors. California suffered a high rise in liability costs during the 1980s, but after passing Proposition 103, loss costs dropped dramatically in 1990s as follows:

- by the abolishment of the bad faith doctrine, which stopped fraud, attorney involvement, and excessive claiming;
- by insurance carriers and state and local law enforcement that fought against fraud aggressively;
- by uninsured drivers being banned from suing for pain and suffering according to Proposition 213;
- by comprehensive reform of the residual market, which accelerated cost control:

382 See David Appel, Revisiting the Lingering Myths about Proposition 103: A Follow-Up Report (September 2004), at 3.


384 Id. California Supreme Court changed liability rules, eliminated one of the most expensive liability rules for insurance companies in 1988. It reduced costly lawsuits, which fell from 91,000 in 1988-1989 to 42,000 in 1998-1999.

385 Id. Proposition 213 is the Personal Responsibility Act of 1996, which prohibited compensation for any non-economic losses from auto-crash injuries against drunk drivers, uninsured car owners, and committing crimes or fleeting felons involved in auto accident. The amount of the influence-related driving was dropped by approximately 60 percent.
by improvement of vehicle and highway safety, a strong seatbelt law, and strong enforcement of laws against driving-under-the-influence or alcohol driving, which resulted in a reduction of critical car accidents.\textsuperscript{386}

However, research also revealed that the level of premiums did not follow the level of losses due to the regulation; loss costs in California started to decrease as early as 1991 but premiums did not react until at least 1997.\textsuperscript{387} This lag can be considered as one of the failures of Proposition 103 because due to the regulatory interruptions, such as Proposition 103, insurers were not able to quickly react to cost increases or decreases, so insurance carriers tended to withdraw from the market or hesitate to change the premiums initially.\textsuperscript{388}

5. The repeal will have no serious impact on the insurance industry

Repealing the MFA will not have big impact on insurance practice for the following reasons:\textsuperscript{389}

- the states also regulate a lot of anticompetitive practices;\textsuperscript{390}
- lots of the practices that are challenged for violating antitrust laws do not need immunity because, in actuality, they are not violating antitrust laws; and

\textsuperscript{386} See Appel, supra note 382, at 3. California enacted the strict seat belt, alcohol-impaired driving and street construction safety statutes in the U.S.

\textsuperscript{387} Id., at 5.

\textsuperscript{388} Id., at 10-11.

\textsuperscript{389} See ABA Section of Antitrust Law, State Antitrust Practice and Statutes (Third), Volume I & II, (2004); see also William J. Haynes, Jr., State Antitrust Laws. (1989) at 224 and Appendix B.

\textsuperscript{390} New York State's antitrust statute, the Donnelly Act is the example.
• when a state intends to displace competition and actively supervises the insurers’ practices, the practices would be insulated by state-action immunity under the Parker doctrine. 391

For the last argument that the Parker doctrine can substitute for the McCarran exemption if the MFA were repealed, the Parker doctrine would narrowly reach activities that private parties engaged in without adequate government supervision. 392

If the McCarran-Ferguson Act was repealed and insurers were subject to federal antitrust laws, the federal law would not preempt all inconsistent state antitrust laws, unless the following:

• Congress clearly preempts the state law by statute;
• there is a congressional manifestation of interest to “occupy the field”; and
• an actual conflict arises between federal and state law. 393

The residual impact of repealing the MFA would make states regulate insurers more actively or enact some “safe harbor” provision in its statutes for clear exemption if states want to immunize the activities of the insurer. 394

The American Bar Association (hereinafter referred to as “ABA”) favors repealing the McCarran exemption but also favors providing safe harbors to preserve precompetitive joint activities and protect the chilling fear of possible antitrust litigation.

391 See Hovenkamp supra note 345, at 26.
392 See id, at 27.
394 Some states insulate insurers to varying degrees by enacting law similar to McCarran-Ferguson Act. Other states bar the anti-competition activities and conspiracies in restraint of insurance trade.
The ABA believes that the negative impact of the repeal will be decreased by providing statutory safe harbors, which include the following:

- collecting and sharing past loss-experience data to help small companies to compete effectively;
- standardizing policy forms to enable consumers to understand and compare the forms;
- allowing cooperative activities that create pools or joint ventures for underwriting uncertain or tremendous risk;
- participating in residual markets and cooperating in making rates and policy forms; and
- certain cooperating and joint activities that would be pro-competitive in the insurance market.

However, it is not reasonable to repeal one act and create the safe harbor legislation for the same purpose, such as benefitting the public and insurers by promoting competition. Some safe harbor provisions are also vague and difficult to grasp in a concrete way, such as the definition and scope of pro-competitive activities.

6. The federal courts need education and experience

From this point of view, the MFA should be repealed to give the federal courts a chance to review insurance antitrust cases. The federal courts have little experience evaluating substantive antitrust disputes involved in insurance claims. This experience is

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395 See Statement of Donald C. Klawiter, supra note 5, at 12, 57.
especially important in rule of reason cases, which are mainly decided by the court's experience and knowledge regarding the workings of a market.

This view was expressed by New York State Attorney General; the Attorney General expressed that repealing the MFA exemption will enhance competition, like securities and environmental sector, and enable public and private litigants to investigate and prosecute anticompetitive conduct in insurance industry under federal law. It will lead the federal court to produce possible claims, outcomes, and penalties so that a federal forum can reduce the burdens of inefficient litigation.396

7. There is no reason to treat the insurance industry specially

The insurance industry is neither unique nor different from any other industries. For instance, banking also faces uncertainty about future costs, but the banking industry does not have an antitrust exemption.397 American consumers have the right to be confident that insurance rates reflect competitive market conditions, not collusive behavior.398 The McCarran exemption is an industry-specific exemption, unlike the labor exemption which is a broad-based policy exemption. The exemption is narrow, but it applies very deeply and chills the original legislative intent to ensure prudent risk transferring.399

396 See supra note 370, at 29.
397 See GAO supra note 80, at 3.
398 See supra note 5, at 3.
399 Id. at 4.
Recently, bills have been introduced in both the House and the Senate to repeal or limit the antitrust exemption. The Health Insurance Industry Antitrust Enforcement Act of 2009 (HR 3596), which was sent to the Senate, partially repeals the exemption to antitrust law for the health insurance industry. The bill would authorize the government to prosecute insurance companies if they are participating in price fixing, bid rigging, or market allocations.\(^{400}\) The result is regulation of prospective price fixing and cartel-like behavior, for which most industries would be summarily charged.

B. Arguments for maintaining the antitrust exemption under the MFA

The NAIC and the insurance commissioner seem to agree that keeping the McCarran exemption will enhance consumer benefits and protections for the following four reasons:\(^{401}\) (1) repealing the insurance exemption could create a legislative vacuum, years of uncertainty, instability, and unpredictability; (2) the McCarran exemption enables insurance carriers to engage in supervised but cooperative businesses that foster proper pricing, consumer selection, and help to maintain the integrity of the marketplace instead of reducing competition and raising costs; (3) the repeal would not enhance the reliability, affordability, or availability of insurance to consumers. Insurance is not only fit for direct regulation, but also specific-performance standards prevent unfair trade practices and operations in place of vigorous competition. Insurance products impose the additional risk of failure due to insolvency, which may happen if an insurer mishandles

\(^{400}\) See Congressman Jon Porter, Congress Moves to Repeal Anti-trust Exemption for Insurers, Akerman Practice Update (October 2009).

\(^{401}\) See supra note 84, at 113.
policyholder premiums; 402 and (4) the insertion of federal antitrust authority in the
insurance industry can jeopardize existing benefits including the following: 403

- standardized risk classifications and terms-of-policy forms that enable data to be
  more credible;
- consolidated data and data analysis, which is reliable for rate-setting;
- sharing advisory loss costs and common policy forms, which enable competitors
to save costs and to access or expand resulting in an increasing number of
competitors in the insurance market and in an increased competence; and
- the residual market and joint underwriting associations, which support a
  meaningful safety net for customers who cannot secure certain coverage, such as
  automobile, medical malpractice, and workers compensation insurance.

The Insurance Service Office (hereinafter referred to as "ISO") believes that the
McCarran exemption is meaningful to the insurance industry because if the McCarran
exemption was repealed, the activities of the ISO will be prohibited to evaluate the pro-
competitive activities. The ISO cooperates with insurers for the following benefits:

- to improve the awareness of insurance costs by analyzing data and making acute
  projections of future claims payments, which enables proper price calculation;
- to introduce economies of scale; if the individual insurer has to pool, analyze, and
  processes data, the costs would be enormous, so insurers have to decide whether
to enter a new insurance market or continuing business in the existing insurance
market;

402 However, this risk is similar to the other financial sectors, such as bankruptcy, bank runs, etc.
403 See supra note 84, at 115.
• to make market entry easy by allowing insurance carriers to enter geographical markets or to enter certain product lines easily by saving on start-up costs; and

• to develop reliable data because availability of a credible industry database, which increases data quality, helps insurers develop or innovate products, and enables regulators to compare and evaluate products. 404

Many states allow an exemption for property/casualty and workers’ compensation products to benefit from cooperative rating. However, other insurance products also have the potential risk to violate antitrust law if the insurer uses same rate. The data needed to make reliable predictions and the statistical accuracy needed to calculate the price can come from cooperation with insurers.

There is an exemption rule in filed-rate cases regarding the access of the rating organization, but it is difficult to use the filed-rate doctrine. The Court decided that a peer review process to determine the properness of a health care claim was outside the scope of the insurance industry; thus, the Court applied federal antitrust law. 405 In order to calculate the insurance rate, the balance between premiums and the insurance proceeds, and proper indemnification, the insurance policy must be standardized among insurance companies. For example, standard automobile insurance had the same general terms and conditions in Korea because the terms related legal liability and criminal immunities. 406 Advocacy of cooperation rather than competition in the insurance industry extends to

404 See Statement of Kevin Thompson (Senior vice president of ISO), supra note 5, at 14-15.

405 Id.

collective drafting of common policy forms. The consumer cannot easily compare the exact prices of insurance products without common forms.

Pools usually set up high risks or unusual risks that a single company cannot underwrite due to lack of capacity or underwriting ability. For risk spreading, risk pooling is acceptable because the risk cannot be insured without pooling. However, if pooling is connected with joint underwriting and is done with a rating agreement, it can be challenged as anticompetitive conduct even though the insurer needs to exchange or aggregate loss experience data to precisely calculate the future rate.

C. Factors to consider before removing insurance immunity

1. The original intent behind creating an insurance immunity

The reasoning and background of the MFA and its exemptions are that the cooperation, rather than competition, can maximize the public welfare based on economic theories: the noteworthy economies of scale in production and sharing of information can prevent adverse selection and insolvency in the insurance business. It will be difficult to rely on a model of the expected loss estimated based on individual policyholders so actuarial accuracy of the calculated premium depends on significant data of a large number of policyholders. Individual insurance companies, even huge companies dealing with multiple insurance products, may be short of adequate internal

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historic data to achieve the necessary analysis with confidence.\footnote{409} There is an argument that this inability extends even to projections of future losses on prospective policies. Combined analysis on this point should thus be exempted from the grips of antitrust law.\footnote{410} There are clear scale economies in the business of insurance, which include the cost benefits of a large risk pool and the cost benefits of standardized policy sales. If a product can be provided in the insurance market with the same rate and policy forms, insurers can take advantage of the effectiveness and scale economies and then share the benefit with insurance consumers through cheap and innovative products.\footnote{411}

Groups that support cooperation rather than competition extend that support to collective drafting policy forms in the insurance industry. Consumers are considered better able to buy when the policies have only a few changeable parameters, such as price.\footnote{412} This argument proceeds that uniformity in policy terms and conditions thus actually favors competition. Through common policy forms, the data needed to compose reliable predictions is available, and, thus, the system is more prone to accurate and statistical analysis. In addition, reinsurance companies would have difficulty bearing risks if the uniformity provided by shared policy forms is barred, making insurance products customized, even in similar lines of insurance.\footnote{413} For example, Nebraska provides an exemption for state-allowed insurance activities. The Consumer Protection Act, § 59-

\footnote{409} Supra note 70, at 856.

\footnote{410} Patricia M. Danzon, The McCarran-Ferguson Act: Anticompetitive or Procompetitive, Regulation, (Spring 1992), at 38-47.

\footnote{411} See Butler & Ribstein supra note 35, at 6.

\footnote{412} Insurance exemptions in antitrust law are perhaps intended to foster economies of scale in production of the information needed to prevent adverse selection and insolvency. See Chandler, supra note 70, at 837.

\footnote{413} See supra note 70, at 856, 857.
1617(1) provides that “the Consumer Protection Act shall not apply to actions or transactions otherwise permitted, prohibited, or regulated under laws administered by the Director or Insurance.”

2. States strengthen state antitrust laws: bid rigging

The recent trend is of many states reducing or repealing the insurance exemption. State attorneys general have now exercised antitrust law enforcement authority and have increased intervention in recent years. The attorneys general in many states seek enforcement action and investigations with the help of their state insurance departments. In the insurance context, influential states like California, Texas, and New Jersey have repealed, all or in part, the former immunity exemptions and have made state antitrust law applicable to the insurance industry. Every state and the District of Columbia has its own antitrust laws, which normally focus on anti-competition infractions, like violations of federal antitrust laws. Regarding exemptions for the insurance industry, some states have statutory exemptions for certain insurance activities.

For example, the Donnelly Act, New York’s antitrust law, exempts insurance actions in § 340(2):

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414 In 1974, Nebraska enacted this Act, which includes antitrust provision similar to the substantive part of the Sherman Act, the FTC Act, and the Clayton Act. See ABA SECTION OF ANTITRUST LAW, STATE ANTITRUST PRACTICE AND STATUTE (4TH ED. 2009), at Nebraska 30-1–30-2.

415 See ABA Antitrust, supra note 64, at 35-36.

416 See Testimony of the NAIC, supra note 84, at 111.

417 See supra note 64, at 35.

418 See e.g., N.Y. GEN. BUS. LAW §§340-347, which was enacted in 1899.
Subject to the exceptions hereinafter provided in this section, the provisions of this article shall apply to licensed insurers, licensed insurance agents, licensed insurance brokers, licensed independent adjusters, and other persons and organizations subject to the provisions of the insurance law, to the extent not regulated by provisions of article twenty three of the insurance law; and further provided, that nothing in this section shall apply to the marine insurance...

The New York Appellate Division found that New York could prosecute insurance companies for bid rigging in violation of the state antitrust law because the conduct occurred while the Insurance Law was not then “in force and effect.” The New York Court admitted that the attorney general might investigate insurance antitrust practices through the NY insurance department because they had concurrent jurisdiction, and the exemption did not cover price fixing. Insurance law authorizes the insurance department to regulate trade practices in the insurance business and provides that the regulation authority reaches unfair competition. Activities that prohibit anticompetitive activities include monopolization agreements that lessen competition, refusals to do business based on rates, rebating and discrimination in property insurance rates, sharing a commission, and offering favors to induce the insured. Thus the insured is basically forbidden from receiving rebates or favors. It exempts insurance-related activities to the

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419 Insurance code provisions relates to property-casualty rates. *See supra* note 64, at 37. This provision provides the limited exemptions.


422 *N.Y.Ins.LAW §§2301-2409.*

423 *See N.Y.Ins.LAW §2316(a), §2324, §2324(a).*

extent that the activity is subject to regulation by the commissioner of insurance of the state or is authorized by the Insurance code, including joint underwriting or joint reinsurance arrangements. In Missouri, the Supreme Court concluded that regulated industries were not de facto exempt from application of the Missouri Antitrust Law. However, insurers may act in concert with respect to some rate-setting activities with certain qualifications.

There was recently a famous insurance antitrust case dealt by a state. New York investigated and accused the defendant of bid-rigging and price fixing, and the parties reached a civil settlement. Marsh, American International Group (hereinafter referred to as “AIG”), ACE, Aon, Wills and Zurich as well as employees of these companies pled guilty to antitrust and fraud-related charges. Five insurers worked with Marsh & McLennan (hereinafter referred to as “Marsh”), an insurance broker, to place business. Marsh instructed the companies to submit preserving quotes on businesses where Marsh had predetermined that the insurer would win the bid. Marsh sometimes furnished the favored carrier’s bid or range; the practice, therefore lead to noncompetitive bidding for

425 Mass.Ge.Laws.Ann.ch176D, §§1-4 and ch 93, §7. This chapter prohibits unfair methods of competition and unfair and deceptive acts and practices in the business of insurance. Section 3(4) forbids agreements or concerted action to commit any act of “boycott, coercion or intimidation resulting in or tending to result in unreasonable restraint of or monopoly in, the business of insurance.” Section 3(7) prohibits unfair discrimination in the rates charged for life insurance and in the terms and benefits under life insurance policies.


427 MO. REV. STAT. §§379.331, .333, .430.

Marsh's favored insurance company.\textsuperscript{429} Marsh solicited fictitious bids from insurance companies so that business on a particular deal could be forced to the insurer favored by Marsh, that is, to the insurer who would distribute the most to Marsh.\textsuperscript{430} The consumer thought it was getting the benefits of compensation, but it was not. As a result, twenty employees have pled guilty, six companies have settled, and a total of over $3 billion in restitution and penalties has been retrieved on charges of antitrust and other violations. Marsh provided the insurance broker and consulting services and received contingent commissions from the insurance companies. In return, Marsh protected those insurers from the competition and threatened insurance carriers that tried to engage in true competition. Marsh did this business through supplying their clients' false and inflated quotes for selecting insurance policies and by providing incentives for the employees to sell policies of the insurer that paid commissions to Marsh. These insurers were AIG, ACE, the Hartford, and Munich American Risk Partners. As a result, Marsh achieved contingent commission payments of about $800 million of Marsh's $1.5 billion earnings in 2003 alone. Marsh settled to pay $850 million for 4 years, which will reimburse clients who held Marsh as their broker from 2001 to 2004.\textsuperscript{431} It was possible because of New York's Donnelly Act and New York antitrust law, which exempts property and casualty insurers but not brokers and not the business of insurance.\textsuperscript{432} However, if the case had

\textsuperscript{429} See Questions and Answers, THE McCARRAN Supplemental submission to the Judiciary Committee On behalf of the Office of the Attorney General of the State of New York, \textit{supra} note 5, at 29.

\textsuperscript{430} \textit{Supra} note 5, at 3.

\textsuperscript{431} See \textit{supra} note 423.

\textsuperscript{432} The McCarran-Ferguson Act exempts the insurance business, which can include brokers if the challenged fact is within a certain category. However, the exemption is lost if the broker violated the following provisions: (1) Fraudulent Business Practices under New York Executive Law ver, the exemption is lost if the broker violated the following provisions: (1) homa §1662. p.ecurities Fraud under New York
been prosecuted under the federal antitrust law, the charge would have encountered a
defense under McCarran-Ferguson Act.\textsuperscript{433}

3. State legislation repeals exemptions

Recently, many states have tried to repeal or limit state antitrust exemptions to the
insurance industry, including states such as California, Texas, and New Jersey. In 1988,
California repealed the common provision of the antitrust exemptions and left two safe
harbors provisions for sharing certain historical data and for taking part in state-approved
residual markets with certain provisions made by voters.\textsuperscript{434} In 1990, New Jersey removed
its immunity for joint ratemaking in private passenger automobile insurance coverage by
excluding the "collection, compilation and dissemination of historical data."\textsuperscript{435} That is to
say, New Jersey removed the exemption for certain aspects of private passenger
automobile insurance, but kept the exemption of "the activities, including... joint
underwriting or joint reinsurance... of any insurer, insurance agent, insurance broker,
independent insurance adjuster or rating organization to the extent that such activities are
subject to regulation by the Commissioner of Banking and Insurance of [New Jersey]
under, or are permitted, or authorized by... [the insurance code.]"\textsuperscript{436} In 1991, Texas got

\textsuperscript{433} Supra note 5, at 5.

\textsuperscript{434} See supra note 64, at 40. It was known as Proposition 103 which eliminated exemptions for all joint
action on rates and rate-related data extending beyond the collection of historical loss statistics, however,
sharing historical data would not violate the antitrust anyway.


\textsuperscript{436} Id. at 56:9-5.
rid of its insurance exemption except for “actions required or affirmatively approved by any statute of this state... or by a regulatory agency of this state.”\textsuperscript{437} Texas provides that existing federal exemptions remain in force “except than an exemption otherwise available under the McCarran-Ferguson Act does not serve to exempt activities under this Act.”\textsuperscript{438}

D. Recommendation: keep the status quo and allow an OFC

1. Insurance products specifically require an antitrust exemption

Insurance products are unique, complex, and personal products that are distinct from other financial products, such as the products of banking and securities. Although other financial products are basically purchased to make a profit from taking risk, insurance products are purchased to compensate for avoiding or transferring risk elsewhere.\textsuperscript{439} Thus, the regulatory concern regarding insurance is the insurable interest or the interest of the policyholder and the insured rather than the profit of policyholder.

Since the true cost of insurance is not verified at the time the product is sold, insurance companies need to collect historic loss data and claims statistics to price their products. The properness of the product price can be confirmed only after the promised behavior or event occurs and the proceeds due by the insurance policy are paid. For more accurate pricing, the information sharing allowed through an antitrust exemption is


\textsuperscript{438} Id., see also Attachment: State Antitrust Laws and Exemptions, supra note 84, at 126.

\textsuperscript{439} See Testimony of NAIC, supra note 84, at 109-111.
required. The insurance products also need policy standardization created by cooperative activities among rivals because standardized terms and conditions enable consumers to compare, enable data to be more reliable, and ensure proper indemnification.

2. The McCarran exemption promotes competition

It is not easy to clearly delineate the merits and drawbacks of repealing the McCarran exemption. In state governments, there are divided opinions about repealing the exemption; for instance, the New York State Attorney General in support of antitrust enforcement debates with the Illinois State Commissioner of Insurance Department who argues as a regulator.\textsuperscript{440}

Sharing advisory loss costs enable insurers to save costs, to calculate premiums, to predict future claim amounts, and to expand market sharing easily; the convenience of sharing especially helps to increase the number of small insurance carriers in the market, which help make the insurance market competitive. The insurers heavily depend on former statistics to calculate future payments; therefore, cooperation with competitors by sharing experiences is required to gather precise and predictable prices. Sharing also helps new market participants gain access to information for which they do not have independent data and helps consumers and businesses save costs in calculating premiums.\textsuperscript{441} Those new market participants can then continually increase market competition and innovation.

\textsuperscript{440} See supra note 5, at 64-77 and 97-108.

\textsuperscript{441} See Testimony of NAIC; supra note 84, at 111.
3. States strengthen the antitrust laws and limit the scope of the exemption

The McCarran immunity does not give the insurance industry ultimate, limitless preemption against federal antitrust laws, but courts have interpreted the scope and condition of the exemption more narrowly and reasonably than in the past. Therefore, the argument of excessive exemption is not exactly applicable in the current regulatory scheme, which constantly reflects environmental changes. States already strengthen the state antitrust laws and repeal or limit the exemptions for the insurance industry. If an OFC is enacted, the federal chartered insurers cannot claim the McCarran immunity.

To maintain the current insurance activities, the industry cannot rely on general exemption rules, such as state action immunity, to protect the necessary and precompetitive practices in the insurance industry because the general exemptions do not provide clear standards and because the general rules have different requirements than the MFA; so repealing the MFA will lead to uncertainty and useless lawsuits, which will consume large costs and can lead to increasing prices in the insurance market.

4. Some insurance areas require expert regulation and cooperation

The insurance industry is considered a specific area that needs special treatment by expert regulators rather than general regulators, including the Federal Trade Commission. This special treatment is required and justified by the following reasons: 442

442 See Harrington, supra note 215, at 121.
the insurance industry is surrounded in uncertainty because each insurance product is different, and future behaviors and events are hard to predict;

- insurance products are complicated such that the consumer cannot understand the contents and the condition or choose the right product, so the consumer lacks the integrated insight necessary for the complete market; and

- the insurer and the consumer are limited by the changes in the market because of regulation; therefore, extreme profits are relatively controlled by the statute and regulation.

In conclusion, the insurance market has latent and systematic characteristics that require the exemption from antitrust law, even though there are opposing opinions:

- insurance is predictable through statistics, and insurance products are similar to each other and are standardized because of regulations; and

- the duty to explain is enforced; and the necessary information is transparent and easy to obtain, so the consumer can easily compare insurance products.

In addition, the McCarran exemption is required for residual markets, joint underwriting, and pooling. Purely competitive policies cannot resolve the problems or avoid underwriting uncertain or tremendous risks. Some cooperation is needed, namely price fixing and joint activities to underwrite residual markets, national catastrophes, and unpredictably high risks.

5. Symbiotic approach to the antitrust exemption for insurance by introducing an OFC
This thesis recommends stopping the proposal to repeal the MFA and instead recommends establishing an OFC to encourage a symbiotic relationship between state and federal authorities. The antitrust laws reflect public policy and society’s belief that competition can promote economic, political, and social well-being. In some cases, we must choose different approaches to harmonize significant public policies with the regulatory system. Although the McCarran exemption is industry-specific, unlike the labor-conduct exemption to protect labor unions or research joint venture to create incentives for precompetitive behavior, the McCarran exemption benefits not only the insurance industry but also the public by providing better insurance service. American antitrust policy has evolved to make the requirements of the McCarran exemption clearly necessary for protecting the business of insurance and for permitting this immunity to serve the customers without fear of excessive antitrust enforcement.

The business of insurance had a long relationship with state regulatory systems, and the state admitted the need to share statistics and data as part of standard business practice. Therefore, to ensure the stability of the insurance business’ customary practice, the insurance business needs to be granted an antitrust exemption and the state antitrust application needs to be left in place. Introducing an OFC can balance the federal and state authorities’ regulation of the insurance industry in the matter of antitrust enforcement and direct industry regulation. The federally chartered insurers would be

443 See Testimony of Hoffmann, supra note 5, at 64.
445 See Farmer, supra note 74, at 146.
446 Id., at 147.

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substantially eliminated from the antitrust exemption.\textsuperscript{447} The remaining state chartered insurers should be heavily and continually regulated by state insurance departments rather than by federal antitrust enforcement; thus, the state antitrust enforcement would deal with the insurance antitrust issues. It is naturally anticipated that the MFA exemptions will be limited by enforcement of state antitrust law.

III. Symbiotic application needed for the competition policy in Korea

A. Antitrust immunity for the Korean insurance industry

1. The insurance industry needs an exemption from the application of antitrust laws

   a. General application of competition law to the insurance industry

In the 1980s, the Korean insurance industry was exempted from or only subject to a limited application of the competition laws. However, currently, the insurance-specific exemption provision was abolished and a general exemption was applied to the competition law. The KTFC mainly regulates the insurance industry in the following areas:

- corporate mergers – where the FSC plans to authorize the mergers between insurance companies and other financial institutions, the FSC should consult with

\textsuperscript{447} See Harrington, \textit{supra} note 215, at 63.
the KFTC in advance about whether the KFTC significantly restricts mutual competition between financial institutions; 448

- regulations on financial holding companies – where the insurance company tries to convert into or to establish a holding company, the insurance company must follow some restrictions, like selling a generally affiliated company; and

- improperly concerted acts 449 – improper cartels such as the act of fixing, maintaining, or changing prices are subjects of common and important regulations in the Korean insurance industry.

b. Arguments for the exemption of the insurance industry

Assuming the aim of competition policy is to promote a company’s competitive ability and public welfare, the competition policy can apply to the insurance market differently based on the maturity of industry, the effect on the national economy, the general practice of market participants, and the market structure. 450 The competition policy for the insurance industry must be based on effective competition rather than perfect competition, which can be attained by admitting that some degree of scale economies is required to guarantee pooling of risks and satisfying the law of large numbers. This effective competition for insurance companies can be accomplished by maintaining the minimum market share to calculate the proper rate, leveling off of risk,

448 ACT ON THE STRUCTURAL IMPROVEMENT OF THE FINANCIAL INDUSTRY §4 (4).

449 These acts are precisely prescribed in “MONOPOLY REGULATION AND FAIR TRADE ACT, Chapter 4 Prohibitions on Improper Cartels”.

sustaining the accident rate, and fulfilling the law of large numbers. In this sense, the insurance industry needs an exemption from competition laws to operate businesses, satisfy the solvency margin, maintain proper rates, and thereby contribute to the consumer welfare through effective competition.

The following issue must be considered: whether competition is the highest and ultimate good among market participants and in the country wholly because satisfaction from insurance products will be accomplished in the future and because the reserve must be maintained to pay the proceeds. Lower prices can lead to insolvency problems such as decreasing profits, violations of the solvency margin standard, and poor service such as disputes about whether the claim is applied to exclusion of the policy. In financial areas, however, the regulator focuses on the prudence of the company in protecting financial consumers and their money. Usually the depository system secures the returns. Historically, however, the national security or insurance system does not work properly in real emergency situations, and the system also needs tremendous money to set back ordinary situations. In this prudent perspective, the regulations and guidelines are compelled upon the industry, which may be a burden to strict, complete antitrust application. In that case, the better policy is to secure the public welfare in the short and long term together.

Competition can lead to efficiency. Sometimes, however, people pursue different directions, like preparing affirmative action to minor competitor that is not ineffective in the competitive point of view. The right way may be to adhere to anticompetitive policies in the light of legitimacy and reasonableness, as is used in the rule of reason standard. A minority view may seek reasonable alternatives or exceptions in the pursuit of
effectiveness in operation and of welfare for the consumer.\footnote{Robert H. Bork, \textit{The Antitrust Paradox} (1993).} It is doubtful that cartels are always wrong and that any type of cartel is evil. Former scholars and defenders of antitrust litigation already reviewed and researched these questions. In a recent example, the U.S. government tried to save financial companies and three domestic automakers using a bailout rescue, in spite of the method being anticompetitive. The bailout was not fair from the stand point of the domestic and foreign competitors of the bailed out firms because Toyota, Honda, and Hyundai auto companies also have factories, employees, and dealers in the same market.\footnote{Nobody raises issues for this kind of case from antitrust statues, however, regardless of whether the antitrust issues meet the exception, like the doctrine of state action; there is no rule without exceptions. On the other hand, it would be an interesting approach to review the GM/TOYOTA case in 1983. The FTC voted that the proposed joint venture between GM and Toyota would violate the Clayton Act and the FTC Act by lessening competition in the manufacture or sale of small automobiles. The joint venture was ultimately launched subject to limitations, but one can wonder nowadays how to evaluate the past decisions regarding putting several limitations to prohibit 'lessening competition' and about the recent discussion of the huge bailout for GM by Congress. See Kathryn M. Fenton, \textit{GM/Toyota, Antitrust Journal}, Vol. 72 (2005).} They were treated unequally, in an anticompetitive way. When other financial institutions and manufacturers failed, they had to go bankrupt or liquidate according to principles of the market, principles of efficiency under the doctrine of competition, like Lehman Brothers Holdings, Inc. The original purpose of promoting competition, however, is to increase consumer welfare, and if the whole industry failed under when guided only by unregulated competition, the consumer welfare would be facing disaster. Thus, there must be an exception or an allowance for flexible application of the antitrust rules in specific situations in the insurance market, too.

c. Historical review of antitrust law in Korea

Although Korea basically promotes the principles of a market economy as the center of its economic order, the economic activities of individuals and corporations have
continuously been overwhelmed by government intervention. This is true because the Korean government, during a progression of economic development plans beginning in the 1960s, tried to overcome structural weaknesses and to decrease economic dependence on other countries by accomplishing an export-oriented economic development policy. In order to implement these goals, the government relied highly on a handful of large-scale enterprises, and the government supported these corporations and enterprises in many aspects of its economic policy, including tax exemptions and encouraging the distribution of bank loans. 453

(i) Enactment and early development: 1980s

While the early 1980s marked the emergence of Korea as a newly developed nation, government policies resulted in monopolistic domestic markets and allowed a small number of large-scale enterprises to control most of the nation's key industries. The ramifications of these policies on the economy were numerous and diverse. First, economic power became concentrated in the hands of a few large-scale businesses and business conglomerates that were favored by the government during its export-driven development years. Second, the Korean government's excessive market intervention and regulation greatly impaired the functioning of the market. To cope with these problems and restore proper market function, the government enacted the Korean Antitrust Act (hereinafter referred to as “KAA”) to promote free competition and fair trade by

prohibiting the abuse of market-dominant positions, anti-competitive mergers, unreasonable cartels, and unfair trade practices. In addition, the KAA was an attempt to simultaneously deregulate many important industries. In 1986, the KAA was amended to introduce new provisions aimed at reducing excessive concentrations of economic power through heavier regulation of large-scale business conglomerates and holding companies.

The Korean antitrust laws were launched in the 1980s. The insurance business was included as an applicable industry in 1984 (KAA presidential decree §2 14). However, the application to the insurance business, especially in the Insurance Business Act, was limited to specific unfair transactions and horizontal agreements that were done without any legal authorization.

(ii) The 1990s

The antitrust laws were amended to include the insurance industry as a regulatory subject area (KAA article 2, 1ho (ba)). However, insurers were exempted for “Prohibition on the Abuse of Market Dominance,” and “Restriction on the Combination of Enterprises and Notification on the Combination of Enterprises” (MONOPOLY REGULATION AND FAIR TRADE ACT, [hereinafter referred to as “MRFTA”] art.3, 7 and 12). In 1996, the finance and insurance businesses were under the regulation of the MRFTA, wherein almost all parts repealed the exemption provision (MRFTA art. 12). In 1999, the antitrust laws were revised by expanding the applicable activities from a list of enumerated businesses to part of a blanket clause.
(iii) Recent development

There are few exemptions for the insurance industry, but the remaining exceptions relate to excessive concentration of economic power such as Scope of Business Groups Subject to the Limitations on Cross-Shareholding (Enforcement Decree of MRFTA art.17 (1)), Disclosure of Important Contents of Non-listed Companies, etc (MRFTA 11-3 (1))

(iv) A recent example of an antitrust case related to insurance

If the challenged act is economically viable, the anticompetitive act can be allowed even if it violates antitrust law. There was an antitrust case in Korea where insurance companies could not compete for group insurance sales against “Nonghyup,” which is supported by government. The government supported Nonghyup because the cost of providing insurance products and the regulatory standard are different; that is to say, Nonghyup could supply cheap insurance products, so-called “Kong-je,” but other insurance companies could not match Nonghyup’s price. As a result, the insurance companies and Nonghyup created a sort of cartel that violated antitrust law because without cooperating with Nonghyup, other insurers could not compete through the bidding system.

When the price is calculated by a single risk and applied by one risk table, such as travel insurance in Korea, insurance products may sell by fixed prices. In that case, almost every distributional channel may sell the same price and induce sales by giving

454 Kong-je is Korean cooperative, benefit society and does not include the loading premium such as marketing costs in calculating premiums so that it provides cheap insurance-like product.
rebates, but lowering the price or expanding market share by giving rebates is illegal. Industry regulation is based on the belief that competition is not desirable, but antitrust law is based on the belief that competition is almost always good.\textsuperscript{455} However, the insurance industry has unique features, even among the regulated industries.\textsuperscript{456} It is administrative waste and causes confusion for the market to dispute between governmental bodies and show the different signals to different government bodies. Thus, it must be harmonized and resolved on a reasonable basis. It can be argued that the some roles must shift from the FTC to the regulators by relocation of administrative function or by securing statutory cooperation in order to manage competition.

2. Statutory antitrust immunity for the insurance industry

a. Legitimate action according to act in the MRFTA

In Korea, there is a provision permitting a general exemption in the Monopoly Regulation and Fair Trade Act (hereinafter referred to as “MRTFA”), Article 58 (Legitimate Actions Taken Pursuant to Acts and Subordinate Statutes) that reads, “This Act shall not apply to acts of an enterprise or an enterprisers’ organization as committed in accordance with any Act or any of its decrees” (emphasis added). To qualify for the general exemption, the first requirement is that the challenged act or agreement must be done under the legitimate Act or its decrees. The applicable acts normally embrace the business of public enterprise which is operated by the government or public institutions,


\textsuperscript{456} See below chapter V. Specific Features in Insurance Industry.
and thus it is not proper to apply competition law. The statutes that describe the exemption include the Post Office Act, Petroleum Business Act, and Grain Laws. The acts of a business institute under the strict regulation by the governmental agency also fall under the general exemption, such as an insurer's joint and mutual agreement obtained approval from the FSA (IBA § 125 (1)). Because this kind of act is strictly regulated by the regulator, the unfair practice will not easily happen, and therefore the exemption can be allowed. However, there is an opinion that regulated industries also must abide by the antitrust laws because the antitrust laws must apply the competitive laws to any areas, even regulated areas.457

The challenged action also must be legitimate.458 There are divided opinions on how to interpret the meaning of “legitimate action”:

- the legitimacy may be decided broadly, according to each individual act, and the interpretation of the regulator in charge of that act has to be considered. Approval or similar active/effective regulation is usually required before engaging in the challenged activity; and

- the legitimate action must be considered with scrutiny to determine whether there is a reasonable justification, such as natural monopoly, public goods, or protection against market failure.

The former opinion can enlarge the scope of the exemption, and thus it can make the application of antitrust law uncertain; however, without specific legislative intention that antitrust laws should supersede other acts, the challenged action must be seriously

457 See Hong, supra note 285, at 42.

458 MRTFA Article 58 (“Legitimate Actions Taken Pursuant to Acts and Subordinate Statutes” [emphasis added]).
evaluated, guided by the rule of reason, to see whether the general exemption can be applied because there is no clear basis to interpret the scope of the general exemption narrowly.

b. Approved mutual agreement under the IBA

There is also an exemption provision in the Insurance Business Act; the exemption is described as following:

Article 125 (Authorization of Mutual Agreement)
(1) In the case that any insurance company intends to enter into a mutual agreement with other insurance company to perform their joint act for their business, the insurance companies shall obtain authorization from the Financial Services Commission under the conditions as prescribed by Presidential Decree. The same shall apply to the case where they intend to alter or rescind such mutual agreement. <Amended by Act No. 8863, Feb. 29, 2008>

(2) The Financial Services Commission may, if it is deemed necessary to advance public interests and facilitate the sound development of the insurance business, order the relevant insurance companies to alter and rescind their mutual agreement, enter into a new mutual agreement or follow the part or whole of their mutual agreement. <Amended by Act No. 8863, Feb. 29, 2008>

(3) The Financial Services Commission shall, if it intends to authorize or order the conclusion, alteration or rescission of the mutual agreement under paragraph (1) or paragraph (2), consult thereabout with the Fair Trade Commission in advance. <Amended by Act No. 8863, Feb. 29, 2008>

This provision was established to permit concerted action to pursue insurance benefits for consumers and insurers together in case of dealing with catastrophic loss, maintaining residual markets, providing incentives to develop new products, and
enhancing public interest.\textsuperscript{459} The mutual agreement must be made among insurers, not brokers or associations. However, the purpose and contents are not limited, so legislation made the provision clear by limiting the scope to the business of insurance.\textsuperscript{460} Mutual agreements must be reviewed by the KFTC before getting approval from the FSC, which must be done expressly and before implementing the agreements.

There is an opinion that the scope of the mutual agreement should be limited to the business of insurance instead of the business of insurer. This opinion was supported by the Supreme Court of Korea. The Court’s purpose was to allow the exemption from the IBA when necessary to maintain the sound order of insurance transactions and to secure public interests. Therefore, even if a cartel was arranged under a mutual agreement in accordance with the detailed standard of prohibiting rebates (special interest) offerings, the concerted act (the cartel) was not fit for the purpose of the exemption in the IBA and thus not allowed. One example would be mutual agreement to cancel free emergency service.\textsuperscript{461}

3. Debate whether the administrative guidance is eligible for immunity

a. Administrative guidance and concerted actions

\textsuperscript{459} There are, for instance, approved agreements to protect the interests of developing new products and agreements to maintain competition policies in Korea.


\textsuperscript{461} The Supreme Court of Korea, 2006.11.23., 2004doo8323.
Legitimate actions, which can be exempt from antitrust laws, include activities by governmental order under any statute, such as enforcement regulation, administrative orders, and executive dispositions. There is debate, however, whether administrative guidance is included in the exemption. Administrative guidance is documentary advice, verbal recommendation, and order-type action done by regulators.\textsuperscript{462} A recent insurance antitrust case involved administrative guidance. The insurer argued, however, that it is not settled which instances of administrative guidance can be exempted from the application of antitrust laws.

There is an opinion that if concerted actions according to administrative guidance are related to price or volume of products, they have strong likelihood to violate the antitrust acts; however, if the concerted activities are related to methods of business, standards of policy, advertisements or representation, they are likely to not have violated antitrust laws as long as they concern the public interest, like consumer protection.\textsuperscript{463} However, this position does not embrace all kinds of cartels and does not provide a clear definition indicating when and which public interests permit the exemption.

b. Binding power rather than legal grounds should be considered to determine the applicability of immunity

According to administrative law jurisprudence in Korea, general administrative guidance is non-binding action and leaves no legal effect on the receiver who can decide


\textsuperscript{463} See Yamashita, \textit{supra} note 462, at 183.
to follow or not to follow the guidance without sanctions; thus, non-binding administrative guidance does not have to be followed, and not-legitimate discretion and not-legitimate administrative guidance are not in the range of the exemption in MRFTA Article 58. However, administrative guidance in the regulated industries of Korea does have executive power and sometimes creates legal grounds under related administrative laws.

In applying Article 58 of the MRTFA, the KFTC and some scholars argued that only legally binding administrative guidance should be considered as under the exemption. Thus, when the concerted activities are done in accordance with administrative guidance under statutory and clear legal grounds according to precisely designated regulations, the administrative guidance can be a legitimate action, and therefore the exemption can be applied. Unless clear articulation of a statute is provided, the administrative guidance may have no immunity power to apply against antitrust laws.

However, the debate is mainly focused on administrative guidance that does not have clear statutory grounds. The Korean regulatory authorities, the FSC and the FSS, sometimes use administrative guidance, which can be in verbal form and has a de facto authority over insurance entities. This issue also brings debate between competition authorities, the KFTC and the insurance carriers, as to whether the exemption can be applied to challenged activities and agreements. Some insurers misunderstand that they

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464 See The Supreme Court of Korea, 1994.6.14. Sungo 93do3247 pangul. The administrative guidance was illegal thus the violation could not be justified.

get an exemption from competition laws when they followed a non-binding administrative guidance, even for anticompetitive agreements or concerted acts with the consent of regulatory authority.\textsuperscript{466} Because of the strong and prevailing patronage role of the government, the insurance carriers have difficulty rejecting or disobeying even non-binding administrative orders. Actually most scholars and the court's precedent do not require legal grounds to determine the existence of administrative guidance. The more important thing is whether the administrative guidance has binding power. In this situation, without a clearly illegal order, the cartel under the administrative guidance should be exempt or should be relieved from the liability, based on principles of equity and efforts to enhance the public welfare.\textsuperscript{467} Thus, even if the concerted activities violate antitrust laws without clear articulation, based on the practical binding power of administrative guidance, relieving responsibility is appropriate or possible under a rule of reason in specific situations, after taking relationships, the degree of order, and the level of anticompetitive effect into consideration.\textsuperscript{468} The Supreme Court of Korea expressed this view in a case considering concerted acts by automobile insurers where the concerted acts resulted in similar ending premiums. The KFTC determined that the similar ending premiums were in violation of the KAA because the ending premiums of the automobile insurance were identical after the loading premium was liberalized.\textsuperscript{469} However, the Court concluded that the regulator, the FSS, gave administrative guidance in setting the


\textsuperscript{467} See Lee, supra note 465, at 101-03.

\textsuperscript{468} See Lee, supra note 465, at 71.

\textsuperscript{469} The insurance premium simply consisted of a risk coverage portion and a loading portion, which includes costs and profit. Before this case, automobile insurance premiums required rate approval in Korea.
loading premiums, which guidance resulted in maintaining same end premiums. This administrative guidance could break the assumption of an agreement to violate antitrust law. However, no evidence was found that the separate price-fixing agreement was made by the influence of the administrative guidance. 470 Thus the challenged act was not considered to violate the antitrust law.

B. Symbiotic checks and balances between regulators and competition authorities

1. Conflict between regulators and competition authorities in the insurance industry

It is difficult to determine how to distribute the authority to implement competition policy between the regulators in the current legal system. Some people argue that the regulation of competition in the insurance industry should shift from the KFTC to the FSC/FSS because of the financial specialty and administrative stability of the latter; however, it is difficult to relocate the administrative function just for the insurance industry and the competition regulator has its own specialties, such as expertise with structural problems and the ability to compare methods with other industries. The modern competition law and policy are related to political, social, economic, and cultural factors, since those factors may affect the policy and the interpretation of competition enforcement in applying antitrust law. The exemption provision is divided between the MRFTA and the IBA, which are in charge of the KFTC and the FSC/FSS, respectively.

470 The Supreme Court of Korea decision (Jan. 28, 2005, 2002 du 12052).
2. Symbiotic checks and balances between the FSC/FSS and the KFTC

The goal of competition policy is to maximize consumer welfare, mostly through low prices; the industry regulator also has similar goals, with different methods and means. 471 However, the regulator also is concerned with the industry’s growth and stability of the market such that the regulator usually focuses on the guarantees of profit and the boosting up of the industry’s economical growth over the consumer welfare. Competition policy is not designed to serve these goals and cannot achieve the regulatory targets. In practice, the policy between competition and regulation confronts gray areas and potential conflicts. 472 To attain higher consumer welfare via low prices, better quality, or higher innovation, competition policy has advantages over regulation:

- the ability to change market structure;
- the ability to infuse the industry with general economic knowledge instead of specific industry knowledge; and
- the ability to avoid the risk of “regulatory capture” 473 and “intellectual capture” 474

On the other hand, the weak points of competition authority include the advantages the regulator has over competition authority when the two authorities aim for the same

471 See Emch, supra note 301, at 186.

472 See id. at 187.

473 “Regulatory capture” is a term used to refer to situations in which government agencies serve in favor of the interests of the regulating industry rather than the public interest that the agencies were originally established to serve. See Wikipedia, available at http://en.wikipedia.org/wiki/Regulatory_capture.

474 “Intellectual capture” results from the particular mindset or ideology dominating both the regulator and the regulated industry through lobbying and the revolving door. See Emch, supra note 301, at 188.
outcomes. Regulations focus on market activities instead of structural remedies, and administrative intervention requires high level of expertise in the industry. 475

In the Credit Suisse case, 476 the Supreme Court reached "a serious conflict between the antitrust and regulatory regimes" and concluded that "the securities laws are 'clearly incompatible' with the application of the antitrust laws in this context." Likewise, the insurance department can preempt some of the insurance antitrust issues against the state antitrust division or court. The Credit Suisse case can be applied to the Korean regulator's conflicting situation; however, to resolve the conflict, the related statute must be clearly prepared by the legislature or interpreted precisely by the court. It is administrative waste and leads to confusion if the market causes disputes between governmental bodies and shows different signals to each agency. Thus, the governmental regulation between different authorities must be harmonized and resolved under a reasonable basis. The Korean legislature must clarify the balance of power between the regulators, the FSC/FSS, competition authority, and the KFTC in order to set a clear rule. 477

475 See Emch, supra note 301, at 189.


477 See Farmer, supra note 74, at 145.
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