

Don't look for national insurance regulation anytime soon Call it a turf war. Or call it looking out for the little guy. Even consumer advocates favor the status quo. By Joseph N. DiStefano Inquirer Staff Writer

Americans pay insurers a trillion dollars a year for protection against the costs of death, illness, accidents, and the monster storms that lawyers call "acts of God."

Insurers have parlayed these customer premiums into investments worth trillions more. They own tall buildings and fat portfolios of bonds and stocks, trade claims in deals with other insurers, and operate easily across national borders, in their endless efforts to spread risks, boost profits, and sell customers more peace of mind.

So when a big insurer collapses (as Philadelphia-based Reliance Insurance Co. did in 2001) or becomes the object of embarrassing billion-dollar financial and business disclosures (as American International Group did in recent months), whole populations of agents, policyholders, shareholders and lenders can end up paying the price, which can take the form of higher fees, reduced coverage, lower investment values - even taxpayer subsidies.

As a time-tested method of sharing common risks, "insurance is fundamentally simple," New York Attorney General Eliot Spitzer noted in his recent accounting-fraud lawsuit against AIG, the largest insurance company based in the United States.

The insurance industry, however, has become less and less simple, with more reliance on complex products, exotic investments, and offshore corporate structures. Yet even the largest U.S. insurers - multinational giants such as AIG, General Electric's insurance units, and Warren Buffett's Berkshire Hathaway Corp. - answer not to a central regulator but to the various state insurance commissions, as if the typical insurer were still a mutual-support club protecting a neighbor-

hood's homes from fire.

To critics, it's as if airline oversight were conducted not by the Federal Aviation Administration, but by state agencies in Harrisburg; Dover, Del.; or Springfield, Ill., with rules varying as pilots cross each state line. Insurance experts are far from unanimous about whether the federal government, or anyone else, could do a better job. Perhaps surprisingly, consumer advocates currently favor the status quo.

It is New York's Spitzer, with his penchant for high-profile cases, who is crossing state lines.

Although AIG is based in New York, the primary regulator for its U.S. property and casualty business is the Pennsylvania Insurance Department - because the largest one of its hundreds of subsidiaries happens to be in Pittsburgh. (For similar reasons, Delaware regulates AIG's life insurance business.)

Still, because AIG has subsidiaries and customers in New York, Spitzer has the right to proceed where the Pennsylvania regulators have not.

Spitzer's probe of the insurance industry began with attacks on giant brokerages that paid kickbacks to favored insurers. In a more recent phase, pressure on AIG led it to say last spring that it had overstated profits by \$4 billion over the last five years and had used reserve reporting rules (which differ from state to state) as well as offshore subsidiaries to make the company look stronger than it really was.

Although such an admission can have strong negative implications for company executives and investors, New York officials are quick to point out that AIG is still a very wealthy company and in no danger of becoming insolvent.

When insurers do collapse due to mismanagement or fraud, the fighting and expenses can drag on for decades.

The Reliance failure cost a record \$3 billion. Part of that cost will be borne by business policyholders, whose claims won't be fully paid. Part will be borne by solvent insurers that fi-

nance the funds in each state - funds that bail out policies for drivers, homeowners and injured workers. The funds pass the costs to policyholders through higher premiums. Also, taxpayers are affected in states such as Pennsylvania that give insurers a partial tax deduction for their payments to bailout funds.

A 2003 report on the Reliance failure by PricewaterhouseCoopers for the California and Illinois bailout funds blamed Pennsylvania regulators for not acting sooner and for withholding information from other states; Pennsylvania has defended its actions.

State regulators, defending their turf, say the extended process is inevitable; yet it contrasts with the rapid way the Federal Deposit Insurance Corp. and other regulators dispose of crippled banks, or even the way big federal bankruptcy cases are often settled by pushing creditors and debtors into a room with their lawyers' meters running.

"The states have ultimately failed in their regulation of the insurance business," Spitzer told the Society of American Business Writers and Editors in May, after denouncing kickbacks by the nation's biggest insurance agencies and filing charges against AIG.

Spitzer acted after a decade in which insurance regulators in Pennsylvania, Delaware, New York and California identified problems with AIG's profit accounting and its use of shadowy Caribbean subsidiaries but did not take actions that ended the practice. *Continued on page 3*

