The Federal Insurance Guaranty Corporation: A Proposal

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THE FEDERAL INSURANCE GUARANTY CORPORATION: A PROPOSAL

In 1969 automobile accidents accounted for an estimated $16 billion in economic loss. Because of the staggering liability that is associated with the operation of motor vehicles, individuals are dependent on insurance companies to provide "financially responsible defendants" who can bear these losses. All too often, both parties to an accident are disappointed to find that the insurance company is not financially responsible because it is insolvent. The injured party finds that he has no one to sue; the insured party finds that what property he has is in jeopardy because the promise for which he has paid, the payment of liabilities arising from an automobile accident, cannot be fulfilled by the insolvent insurance company. Additionally, the state finds its attempts to protect its citizens from the costs of automobile accidents through insurance frustrated by the insolvent company's inability to pay. This note deals with one proposed solution to this problem of the insolvent insurance company—Senate Bill 2236 which would create the Federal Insurance Guaranty Corporation.[1] Though the bill deals with "any enterprise engaged in the business of issuing or reinsuring property, casualty, or surety insurance policies"[2] or reinsuring policies in interstate commerce, this note will principally examine automobile liability insurance problems.

First, the problem of the insolvent casualty insurance company will be delineated. Second, the proposed guaranty corporation will be discussed in some detail. Third, criticism of the plan will be made in order to evaluate its substantive merits. And, fourth, the insurance industry's reaction to the proposal will be discussed.

By way of introduction, the proposal for the guaranty corporation seeks to create a federal corporation to guarantee payment of liabilities not met because participating insurers become financially insolvent. The basic motivation for such a corporation stems from a concern over the increasing number of uncompensated victims and policyholders and the substantial number of companies that have failed in the last few years. Industry opposition to the proposal centers around two fears: fear of

1. 91st Cong., 1st Sess. (1969) (referred to the Committee on Commerce, May 29, 1969).
2. S. 2236, 91st Cong., 1st Sess. § 6(1) (1969).

federal regulation of the industry and fear of compulsory insurance plans under political control. State concerns originate from a fear that the ability to regulate the industry at a state level will be lost.

I. THE SCOPE OF THE PROBLEM

A significant number of casualty insurers have become insolvent in the last few years. Determining the precise number for any given year is a difficult problem for a number of reasons. First, there are no national statistics available, and information must consequently be obtained separately from the various state insurance regulatory commissions. The reporting procedures used by such commissions are not standardized. State definitions of insolvency vary, and the dispositions made of financially distressed companies differ from state to state. As a result of these disparities, such statistics as are available can only be used to indicate a general trend rather than to pinpoint existing abuses and delineate definitive patterns.

The insolvency problem is a part of the larger concern with the high cost of automobile accidents.[3] The problem of insolvent casualty insurers of high risk drivers first gained national attention as a result of Senator Thomas Dodd's investigation in 1965.[4] His summary of the findings of that investigation reveals the extent of the problem.

> We discovered that from 1960 to 1966 seventy-three companies out of 350 engaged in this kind of business collapsed financially, leaving well over a million persons without insurance.
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> This investigation uncovered an insolvency problem of such magnitude that it may rank as one of the greatest insolvency crises in the history of the insurance industry.
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> In 1964, 1965, and 1966 forty-four high risk auto insurance companies failed.
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> Since there are approximately 350 companies doing this type of business, it statistically follows that 12.6% of these companies toppled in this three-year period

3. CRISIS IN CAR INSURANCE (R Keeton, J. O'Connell, T. McCord ed. 1968) [hereinafter cited as CRISIS].
4. *Hearings on S. Res. 40 Before the Subcom. on Antitrust and Monopoly of the Comm. on the Judiciary,* 89th Cong., 1st Sess., pt. 12 (1965) [hereinafter cited as 1965 Hearings].

alone. That averages out to an annual failure rate of 4.19%.

. . . .

Businesses in general are currently failing at the rate of approximately six-tenths of one percent every year.[5]

After these hearings in 1965, the Senate Anti-trust Subcommittee conducted hearings on a broader scale; these 1968 hearings investigated auto insurance as a whole and were not limited to high risk auto insurance companies. High risk auto insurance companies are those companies which specialize in writing insurance on drivers who, because of their poor driving record, or for other reasons, have been deemed to be a greater insurance risk. To cover this greater risk, the insurance companies are allowed to charge a higher premium than that allowed for normal or ordinary risks. Presumably, since they are allowed to charge a higher rate for these risks, it would be thought that they would have no trouble in providing adequate coverage. But, as a matter of fact, they have failed at an alarming rate. As Senator Hart asked, "Why is the high-risk market and the assigned risk population constantly growing in an industry which speaks glowingly of competition?"[6]

An industry spokesman asserts that "[m]ore than 100 small high risk companies have gone bankrupt in the last 10 years."[7]

This same source defines the broader problem this way:

> Automobile registrations, licensed drivers and mileage driven keep rising year by year. Registrations now exceed 100 million cars driven a trillion miles by more than 100 million licensed drivers. Some 900 individual insurance companies collected in 1969 about $13 billion in automobile insurance premiums, 45% of total property/liability writings, and few were happy about it. Big numbers and big problems prevail in all phases of auto insurance.
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> In 1969 automobile accidents killed more than 56,000 persons, injured 4.5 million men, women, and children,

5. *Hearings on S. Res. 233 Before the Subcom. on Antitrust and Monopoly of the Comm. of the Judiciary,* 90th Cong., 2d Sess., pt. 13, at 7394 (1968) [hereinafter cited as 1968 Hearings].
6. *Id.* at 7390.
7. Kellogg, *Review and Preview,* 70 BEST'S REVIEW 72 (Property-Liability ed. Jan. 1970) [hereinafter cited as Kellogg].

> and produced a total estimated economic loss of at least $16 billion.
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> . . . .
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> The insurance industry has been saddled with and blamed for a variety of vexing and so far insoluable problems not of its own making. With the possible exception of lawyers, the present tort liability system satisfies virtually no one. Insurance companies are fed up with mounting losses and undeserved criticism; regulatory authorities and politicians are under pressure; car owners are unhappy with constantly rising costs; young and accident prone drivers dislike restricted markets and surcharges; and accident victims complain about delayed loss statements.[8]

Complicating matters, from an industry point of view, is the fact that casualty underwriting is unprofitable, when profits are figured on an adjusted basis. "[A]utomobile bodily injury liability is . . . about 5.5% in the red, on an adjusted basis, and 1969 represents the 15th consecutive year the stock companies have lost money on auto bodily injury to boost the statutory loss to some $1.8 billion, about 6% of $33 billion earned premiums."[9] Automobile property damage is 10% in the red on an adjusted basis.[10] Automobile physical damage is over 5% in the red on an adjusted basis.[11] The industry figures its losses in this business on the "statutory basis," which is the manner in which profits are reported under state regulatory schemes.[12] However, when investment income is included in the companies' figures, the industry shows a $7 billion profit.[13]

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8. *Id.*
9. *Id.* at 73.
10. *Id.*
11. *Id.*
12. *See* R. KENNEY, FUNDAMENTALS OF FIRE AND CASUALTY INSURANCE STRENGTH 164-69 (4th ed. 1967) [hereinafter cited as R. KENNEY]. Basically, statutory underwriting profit ignores investment income, a major source of insurance company income. This is why companies continue to pay dividends, even with losses. "Statutory underwriting profit" is the balance remaining after losses incurred, loss adjustment expenses incurred, and underwriting expenses incurred are deducted from "earned Premiums" ("premiums which actually belong to the company after release from the unearned premium reserve"). *Id.* at 165.
13. 1968 Hearings, pt. 14, at 8536. (From a statement of Senator Hart characterizing the period 1967-68, the latest period for which truly complete figures are available.)

II. The Proposal Itself

The Federal Insurance Guaranty Corporation Act is closely modeled after the Federal Deposit Insurance Corporation Act[14] and the Federal Savings and Loan Insurance Corporation Act[15] and is intended to "protect the American public against certain insurance company insolvencies."[16] A basic outline of the structure of the corporation as set forth in the bill is here presented to provide a background for understanding the operation and scope of authority of the corporation.

A. Control

The operations of the Guaranty Corporation will be overseen by a three-man Board of Directors. Section 3 of the bill provides that the Comptroller General of the United States will be one of the members of the Board. The President, with the advice and consent of the Senate, appoints the other two members. No more than two of the three directors are to be of the same political party. The President designates one of the three as Chairman of the Board. The three serve six year terms, or until their successor is appointed. "No member of the board of Directors shall be an officer or director of any participating insurer or hold stock in any participating insurer."[17] Additionally, former board members may not be employed by insurance companies for two years after they leave the Board, unless they have served their full six year term, in which case the provision of no employment is inapplicable.

The Board of Directors appoints a nineteen-man Advisory Committee to assist the Board. Section 4(a)(1) calls for the membership of this committee to be composed of representatives from the federal government, the general public, the insurance industry, and state or local governments. The last category includes representatives of state regulatory authorities. Representation on the Advisory Board is qualified to include "[n]ot more than six . . . regular full-time employees of the Federal Government, not less than four . . . representatives of the private insurance industry, and not less than four . . . representatives of State insurance authorities."[18] These members serve two-year terms; government appointees serve only so long as they

14. 12 U.S.C. § 1811 *et seq.* (1964).
15. 12 U.S.C. § 1724 *et seq.* (1964).
16. S. 2236, 91st Cong., 1st Sess. Preamble (1969).
17. *Id.* at § 3.
18. *Id.* at § 4(a)(1).

continue in their government position, unless reappointed.[19] The purpose of this Advisory Committee as set out in section 4(c) is to

> review general policies of the Corporation and advise the Board of Directors with respect thereto, assist in obtaining the corporation [sic] of insurers, industry groups, and Federal and State agencies, consult with and make recommendations to the Board with respect to carrying out the purposes of this title . . . .[20]

B. Finances

Original funding of the corporation is to come from a capital stock of $50 million. The Secretary of the Treasury is to subscribe the original issue as a public debt transaction which will be repaid. Shares will be divided into one thousand dollar units.[21] Thereafter, the fund will be composed of its capital stock and the premiums collected pursuant to the scheme.[22] The net asset value of the fund is limited to "2 per centum of the annual net direct premiums written by all participating insurers . . . ."[23]

> The term "net direct premiums written" means direct gross premiums written on property, casualty, or surety insurance policies, less return premiums thereon and dividends paid to policyholders on such direct business.[24]

Companies pay a fee of "one-eighth of 1 per centum of the net direct premiums written by the participating insurer during the year . . . ."[25] The assessment is paid in semi-annual installments, and such payment preempts "any fee or assessment under any State insurance insolvency or liability security fund law for any period during which the insurance policies of that insurer are guaranteed pursuant to this title."[26]

Section 15 permits the corporation to invest in United States securities under specified conditions. The corporation can lend to a failing insurer upon such terms as are set by the Board of Directors.[27] The corporation can borrow from the Treasury upon

19. *Id.* at § 4(a)(3).
20. *Id.* at § 4(c).
21. *Id.* at § 5.
22. *Id.* at § 10(a).
23. *Id.* at § 10(b).
24. *Id.* at § 6(5).
25. *Id.* at § 13(b)(1).
26. *Id.* at § 10(c).
27. *Id.* at § 16.

a half billion dollars outstanding obligation. Exemption from taxation of FIGC obligations is provided by section 17. Audits and a yearly report to Congress are provided for,[28] with scrutiny by the General Accounting office.[29]

C. Powers

Section 7 of the bill gives the Corporation the necessary powers for its operation, such as the power to make contracts and prescribe rules and regulations. Section 8(b), however, describes the truly controversial administrative powers of the Corporation; this section provides:

> The Corporation shall appoint examiners who shall have power, on behalf of the corporation, to examine any insurer or local insurer making application for guaranty status or whose policies are guaranteed under this title, whenever in the judgment of the Corporation an examination of such insurer is necessary. In making examinations of insurers or local insurers the examiners shall have power on behalf of the Corporation to make such examinations of the affairs of all affiliates of such insurers as shall be necessary to disclose fully the relations between such insurers and their affiliates and the effect of such relations upon such insurer.[30]

In an effort to mitigate the specter of federal regulation, this section further provides that "[a]ll examiners appointed by the Corporation shall cooperate as far as practicable with . . . the appropriate State supervisory authorities and The National Association of Insurance Commissioners."[31] State authorities are granted the right to review copies of the reports and to comment on these reports. It should be pointed out that "'affiliate' or 'affiliates' as used in the foregoing subsections (b) and (c) means any enterprise related directly or indirectly to the insurance activities of the insurer or local insurer."[32]

Failure to cooperate with an investigation can result in contempt proceedings in federal courts.[33] The Corporation is authorized to grant immunity and waiver of prosecution to overcome self-incrimination problems with reticent officials. Companies who fail to comply with a specific recommendation

28. *Id.* at § 19(a).
29. *Id.* at § 19(b).
30. *Id.* at § 8(b).
31. *Id.*
32. *Id.* at § 8(d).
33. *Id.* at § 8(e).

of the Corporation after the hearing process is completed face publication of the disregarded recommendation after a 60-day notice.[34]

Payment of the guaranty occurs only *after state remedies have been exhausted.* A company must be declared insolvent by a competent court, the Corporation must be notified of the insolvency, and the records and files of the insolvent company must be made available to the Corporation before the Corporation is authorized to issue a certificate of assumption.[35] Any person who has a claim against the insolvent insurance company must exhaust his claim against state insolvency funds,[36] the Corporation being liable only for the excess not so satisfied out of the state fund. Additionally, any statutory provisions or policy right entitling an individual to recover from the company must be used before the guaranty provisions may be invoked.[37] The Corporation becomes subrogated to the aggregate claims paid from the guaranty fund against the company or its representative in insolvency proceedings.[38]

The right of participation in the fund is conditioned upon the filing of an application with the proper information[39] and agreeing to comply with regulations applicable while the guaranty is in effect. After approval of the application, an insurer is issued a certificate and must, under such certificate, include in each policy a statement that it is guaranteed by the fund. For an interstate insurer who fails to meet the Corporation's requirements for guaranty of its policies, section 12 provides a thousand dollar a day fine for each policy not guaranteed. These fines may be assessed against the directors of the companies individually if company assets are not sufficient to meet them.[40] Misrepresenting the fact that a policy is guaranteed carries a one thousand dollar fine, or one year in prison, or both.[41]

D. Provisions to Insure the Regularity of Company Affairs

The bill sets out rather extensive provisions to insure that company affairs are conducted in a regular and businesslike

34. *Id.* at § 8(f).
35. *Id.* at § 9(a). Insurance companies are specifically exempted from federal bankruptcy provisions. Bankruptcy Act, § 4, 11 U.S.C. § 22 (1969). *See* Valley v. Northern Fire and Marine Ins. Co., 254 U.S. 348 (1920). Individual states provide their own scheme for dissolution of insurance companies.
36. S. 2236, 91st Cong. 1st Sess. § 9(f)-(g) (1969).
37. *Id.* The fund pays only the excess not covered through other remedies.
38. *Id.* at § 9(h).
39. *Id.* at § 11.
40. *Id.* at § 12(a).
41. *Id.* at § 12(b).

manner. The tenor of these sections is clearly intended to give the Corporation information as changes in the company's operation occur. The drafters apparently hope that earlier receipt of such information will enable the FIGC to act between the statutory reporting dates when any company action threatens the solvency of the guaranteed company. Under state schemes of regulation irreparable damage is often done before periodic statutory reports are filed.

Section 13(h)(1) requires the chief officer of a guaranteed company to report promptly any change in the control of voting stock to the FIGC. Any doubts as to whether control will be changed are to be resolved by reporting the stock transfer. Loans secured by 25 per cent or more of the voting stock of another participating insurer must be reported, unless the borrower has been the owner of record of the stock for a year or unless the stock is that of a newly organized insurer. The required reports must contain:

> (a) the number of shares involved, (b) the names of the sellers (or transferors), (c) the names of the purchasers (or transferees), (d) the names of the beneficial owners if the shares are registered in another name, (e) the purchase price, (f) the total number of shares owned by the sellers (or transferors), the purchasers (or transferees) and the beneficial owners both immediately before and after the transaction, and in the case of a loan, (g) the name of the borrower, (h) the amount of the loan, and (i) the name of the insurer issuing the stock securing the loan and (j) the number of shares securing the loan.[42]

The company must also provide other information so that the Guaranty Corporation may see the full effect of the transaction.

Section 14 provides for termination of the guaranty status of a company upon a finding by the Board of Directors that a participating insurer is engaging in an unsafe or unsound practice. There are hearings on the practices found to be unsafe or unsound, and various time limits are set forth for correction. If the company does not correct the deficiency within the specified time, the Corporation is authorized to publish the objectionable practice. Moreover, the FIGC is authorized to compel the company to give notice of such practice to its policyholders or the

42. *Id.* at § 13(h)(4).

Corporation may send the notice itself. The determinations of the Board of Directors of the FIGC are subject to judicial review as provided within the bill.[43]

Real strength for the Corporation comes from its ability, after hearings, to issue cease and desist orders which are enforceable by injunction in the federal courts, as against officers and agents, if the courts find that a violation of the order has occurred or is about to occur. Companies are given the right to have the courts alter the cease and desist orders.[44]

In an effort to control unscrupulous operators and to prevent so called "dummy"[45] boards of directors, the bill provides in section 14(d) that the FIGC may remove from office or suspend from participation in the affairs of the insurer any officer, director, or other person who

> [h]as committed any violation of law, rule, or regulation, or of a cease-and-desist order which has become final, or has engaged . . . in any act, omission, or practice which constitutes a breach of his fiduciary duty as such director or officer, and the Corporation determines that the insurer has suffered or will probably suffer substantial financial loss or other damage or that the interest of the policyholders could be seriously prejudiced by reason of such violation or breach of fiduciary duty, and that such violation or practice or breach of fiduciary duty is one involving personal dishonesty on the part of such director or officer . . . .[46]

The suspension is effective after compliance with hearing requirements has been had. Additionally, indictment of an official for a felony involving a breach of trust is specified as a ground for suspension. Such suspension continues in effect until final disposition of the charges. "A finding of not guilty or other disposition of the charge shall not preclude the Corporation from thereafter instituting proceedings to remove such director, officer, or other person from office and/or to prohibit further participation in the insurer's affairs . . . ."[47] Penalties for vio-

43. *Id.* at § 14(a).
44. *Id.* at § 14(c).
45. "Dummy" boards are so named because they are made up of directors whose prime asset is a famous name to draw policy holders. These directors usually lack experience in the insurance field and are subject to manipulation by those in actual control. This form of management can easily be abused by the unscrupulous.
46. S.2236, 91st Cong., 1st Sess. § 14(d)(1) (1969).
47. *Id.* at § 14(e).

lation of suspension proceedings and penal proceedings are a five thousand dollar fine, or imprisonment for one year, or both.[48] The fines for violation of this section are made personal against the directors and the individuals involved.[49]

E. Hearings and Judicial Review

The hearings called for as part of the Corporation's enforcement pattern are to be held in the district where the insurer has his principal office. All hearings are public, unless privacy is needed to assure that the parties involved or the policyholders' rights are protected.[50] Review of a final decision is exclusively provided for in section 14(i) which details the applicable United States Code sections and adequately protects the insurance companies' right of review.

III. Criticism and Evaluation of the Proposed Corporation

A. Federal Regulation of Insurance

Will the Federal Guaranty Insurance Corporation bring federal regulation of insurance? That is the way many regulators and industry spokesmen would phrase the debate over the FIGC; it is, however, misleading. For a number of years the insurance industry was free from federal regulation under the doctrine of the *Paul v. Virginia*[51] which said that insurance was not commerce among the several states and thus not subject to regulation under the commerce clause. The landmark case of *United States v. South-Eastern Underwriters Association*[52] changed this in 1944. Shortly after the Court pronounced insurance to be interstate commerce, Congress responded to state and industry desires with the McCarran Act.[53] Very basically, the Act provided that the insurance industry was exempt from federal regulation as long as the states provided adequate regulatory measures. All of the states, quite naturally, had or quickly enacted such legislation.[54] Attempts to encroach on state pre-

48. *Id.* at § 14(g).
49. *Id.* at § 14(h).
50. *Id.* at § 14(i).
51. 75 U.S. (8 Wall) 168 (1869).
52. 322 U.S. 533 (1944).
53. 15 U.S.C. § 1011 *et seq.* (1964). McCarran Act, Act of Mar. 9, 1945, Pub. L. No. 15, § 2; 59 Stat. 33 *as amended by* Act of July 25, 1947, 61 Stat. 448.
54. W. Vance, Handbook on the Law of Insurance § 5, at 40-41 (3d ed. B. Anderson 1951) [hereinafter cited as Vance]. States acted through their Insurance Commissioners to form the "All-Industry Committee" to draft Model Acts. This was done through the National Association of Insurance Commissioners. The bills, with local variations and modifications, were enacted in all but two jurisdictions.

rogatives by the federal agencies were rebuffed by the federal courts where state laws adequately dealt with the problem.[55]

Today, however, broadly speaking, the insurance industry is subject to regulation from the federal sector under various sections of the anti-trust laws, the National Labor Relations Act, and the Fair Labor Standards Act.[56] The Federal Trade Commission can regulate "to the extent that such business is not regulated by State Law."[57]

Matters relating to stock in an insurance company, assuming sufficient size are, moreover, covered by Securities and Exchange Commission regulation.[58] Investment aspects of insurance can be divorced from state regulation of the promise in the insurance contract itself. The SEC has become more involved in insurance regulation in the last few years, since corporate stock has been used in fraudulent life insurance schemes[59] and there has been a temptation on the part of many companies to get easy capital through the use of stock offerings.[60]

The Federal Trade Commission, under its section 5 authority, has been successful in getting at mail order insurers in some instances. This complex area, which involves policies offered strictly through the mails with no other contact with the state, is one which has been ineffectively controlled by a state-centered scheme of regulation.[61] The FIGC would help, since it is primarily concerned with interstate insurers.

The above broad outline of the history of federal regulation of insurance companies raises several questions as to the possible effect of the FIGC legislation. For purposes of discussion it will be assumed that the term, "federal regulation," includes federal standards for (1) what constitutes sound reserves to meet claims, (2) a fair price for the policy, and (3) the form of accounting reporting to be used. These three areas lie at the heart of most current schemes of insurance company regulation.

55. *See* FTC v. National Casualty Co., 357 U.S. 560 (1958) and Travelers Health Ass'n v. FTC. 298 F.2d 820 (8th Cir. 1962).
56. *See* VANCE, *supra* note 54, § 5, at 36-50.
57. 15 U.S.C. § 1012 (1964).
58. *See* R. KENNEY, *supra* note 12, at 157-63.
59. The *1965 Hearings* contain details of stock defrauding schemes in several states. The articular schemes there under consideration involved purchase of life policies on company executives using casualty company stock as consideration. The worthless casualty stock loss fell on the life companies who had to pay on the key man type policies. The basic scheme, of course, had many variations.
60. *See* H. JOSEPHSON, THE CASE AGAINST NEW LIFE INSURANCE COMPANIES (1966) [hereinafter cited as H. JOSEPHSON] for an explanation of the misuse of new stock for high return on investment.
61. For a discussion of this problem, see R. KENNEY at 311-19.

Senator Hart of Michigan, one of the sponsors of the bill, in an address at the joint convention of the National Association of Casualty & Surety Executives and the National Association of Casualty & Surety Agents in the fall of 1969, "gave an unequivocal 'yes'"[62] to the question of whether "federal regulation of insurance [will] supercede state regulations?"[63] Perhaps more important, however, was this exchange:

> Do you forsee that federal regulation will be superimposed on existing state regulation?[64]
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> . . . .
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> "No," Senator Hart responded. "When the time comes, I am confident that the federal legislation for regulating insurance would specifically provide that where state standards are higher than federal standards, the state standards would apply. But it is very unlikely that state standards would be higher than the federal standards."[65]

By the terms of the bill itself, state regulation is neither prohibited nor discouraged. For example, throughout the bill[66] it is provided that copies of information gathered pursuant to the duties of the FIGC be provided the appropriate state regulatory agency. By analogy to the prototypes for the FIGC legislation, the FDIC and the FS&LC, neither of the latter is actually a regulator of banks or savings institutions. Though the analogy is admittedly inapposite in many points because of the complexity of state and federal banking regulation under other measures, nevertheless, these corporations do not come close to preempting the field of banking regulation. State regulatory agencies continue to stay very active in that area.

It is also appropriate to note that this bill covers only the casualty insurance industry. This is so because life insurance companies have as a group taken care of their insolvent companies through merger or acquisition.[67] They have been able to do this because life insurance is more profitable, on the whole, than casualty insurance. The life insurance industry has also been more jealous of its reputation for stability.[68] Health and

62. 70 BEST'S REVIEW 5 (Property-Liability ed. Nov. 1969).
63. *Id.*
64. *Id.*
65. *Id.*
66. §§ 6(11), 8(b), 8(f), 11, 14(a), and 14(d)(4).
67. *See* H. JOSEPHSON, *supra* note 60.
68. *Id.*

accident insurance is covered by such a variety of plans that legislation that provided insolvency protection for this industry would be difficult to draft. For example, the various Blue Cross type plans would have to be adapted to a specific scheme as would Medicare, Medicaid, and Workmen's Compensation type legislation. At the present time, such complexity is undesirable and would introduce an unnecessary factor into an area already saddled with skyrocketing costs. Besides, life insurance and health and accident insurance companies are not generally exhibiting the financial problems that casualty insurance companies are demonstrating. Fire insurance, a portion of the casualty section of the industry, is also holding its own.[69]

Realistically, much of the industry's opposition to the FIGC is based on a fear of spreading federal jurisdiction into other lines of insurance.

> Robert Dineen—former New York Superintendent of Insurance, former president of NAIC, retired Chairman of Northwestern Mutual Life, and now a consultant to NAIG—sees the FIGC as bringing more federal regulation to the insurance industry than it would purport to, or more than the bill's friends in the industry would like. In Mr. Dineen's view: "It is natural and inevitable that the FIGC would eventually expand its powers of regulation to the life insurance industry."[70]

In support of his contention that federal regulation is "no panacea," Mr. Dineen cites the fact that federally regulated banks lost $25 million in insurance company frauds, as well as the fact that federal riot insurance under the Department of Housing and Urban Development has proven less desirable than it looked at first blush.[71] At the same time that Mr. Dineen disdains the FIGC as bringing federal control of all facets of the insurance industry and asserts the deficiencies of federal regulation, he "agrees, . . . that the states must act decisively to create an interstate mechanism to guarantee insurer solvency."[72] This is in effect an admission of the obvious failure of the states and the industry to deal adequately with the problem of insurer solvency. His own solution would of necessity be interstate in character and application.

69. Kellogg, *supra* note 7, at 74.
70. Killen, 70 BEST'S REVIEW 78 (Property-Liability ed. Sept. 1969) [hereinafter cited as Killen].
71. *Id.*
72. *Id.*

Proposals detailing such interstate cooperation are somewhat vague. Interstate cooperation outside of federal endeavors is hampered by the lack of appropriate enforcement powers. Uniform acts[73] and all-industry bills[74] are not effective when viewed in the light of the reality of state political processes. State insurance commissions, whatever they are called in a particular jurisdiction, are subject to varying amounts of political influence and control. Moreover, most insurance commissions are understaffed, underpaid, and under-trained.[75]

Resolution of the dilemma of federal control of insurance regulation brings into focus the disparity between the public's idea of the effect of state regulation and the reality of its capabilities. Indeed,

> [i]t has been well said that the primary duty of an insurance commissioner is to protect policy holders against insolvency and generally loose underwriting and claim practices on the part of insurance companies. That has been the theme song of every convention of the National Association of Insurance Commissioners which was ever held.
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> Noble though this theme be, however, it has its drawback in that the policy-buying public has comė to expect too much of the state supervisory authorities. In short, a license to do business within a state has come to be regarded in too many circles as tantamount to a guarantee of continued solvency when, as a matter of fact, it is no such thing. The granting of a license merely means that on a specific date, the company met certain financial requirements. And history shows that a great deal can happen in the insurance business between examination dates.[76]

The announced goal of the Guaranty Corporation is to give the public that which it now believes it has—a guarantee of solvency of those insurers licensed to do business. The statement on a policy that such policy is guaranteed can literally mean what it says. This aspect of certainty commends the FIGC proposal, assuming two factors: first, that the cost of such guarantee is

73. Proposed by the National Conference of Commissioners on Uniform State Laws.
74. *See* VANCE *supra* note 54, at § 5. The bills came from the activities of the National Association of Insurance Commissioners.
75. *See 1968 Hearings* at 8349 and R. KENNEY, *supra* note 12, at 315.
76. R. KENNEY, *supra* note 12, at 313.

not too high, and second, that the degree of state control that would be assumed by the federal government is effectuating the FIGC's purposes is a desirable allocation of power vis à vis state and federal government. Both points are disputed.

Opponents point to the high cost of running the FDIC and the FS&LC as an example of the inefficient manner in which government programs achieve solvency. They point out that these corporations collect many millions more in premiums than they pay out to cover losses of folded institutions. They argue that insurance at this price is too high. This overlooks the fact that these two bodies are themselves a form of social insurance and that in addition to their actual payment to depositors their standards and supervision contribute markedly to the overall health of the industry; that is, they fulfill their primary goal of protecting the public from shaky institutions. The basis of the argument essentially becomes the oft-heard contention that all bureaucracies, especially government bureaucracies, are inefficient and costly.

Insurance companies themselves are no models of efficiency. One of the prime values of the FIGC could be the streamlining of data gathering and processing.[77] Perhaps such improvement would lower Senator Dodd's estimate

> that for each $100 delivered in direct benefits to policy holders, administrative and other expenses incurred by insurers and others are $125 for automobile liability. Furthermore, approximately 50 percent payout of premiums is low no matter what forms of insurance with which it is compared.[78]

The desirability of federal regulation of insurance is an old debate. The literature on the subject is overwhelming.[79] It is interesting to note that the industry originally sought federal regulation of itself in order to escape the varying state regulatory schemes. Arguments used by companies and regulators alike often amount to mere "rationalizations"[80] such as:

> The case for state supervision is that it is here, we have it, it is an established system, and for at least two gen-

77. *See* R. HENSLEY, COMPETITION, REGULATION, AND THE PUBLIC INTEREST IN NONLIFE INSURANCE 208-09 (1962) [hereinafter cited as R. HENSLEY].
78. 1968 Hearings at 8547.
79. R. HENSLEY, *supra* note 77, at 208 n.4 lists a portion of the "staggering" amount of material.
80. *Id.* at 210.

erations we have developed it and gotten accustomed to it. Even if it is bad, we are used to it.[81]

If the "primary responsibility—*which is to regulate for solvency*"[82] is to be met, insurance commissions of all 54 regulatory jurisdictions must recognize the fact that "[m]any states are both understaffed in their insurance departments and poorly staffed in terms of the qualifications of their personnel."[83] Federal funding of the corporation could eliminate the salary differentials between government service and private industry. Competent, well-trained personnel could be hired; the availability of such qualified personnel is essential to the control of the well versed and well paid industry executives and counsel, since it is obvious that what is not understood cannot be controlled intelligently. Too often, today, state commissions are dependent upon industry sources for the very data they need to regulate effectively. The industry calls the tune in large measure.

In summary, although comprehensive regulation of the casualty industry by the federal government is not a goal of the FIGC, it may be, depending upon further developments, a result of such a program. The proposal, however, should be judged on the merits of what it seeks to accomplish—solvency—and not on speculations about its inevitable development.

B. Relation to Other Control-of-Insolvency Devices

One argument against the FIGC is that standardization of regulation prevents local experiment. In view of the whole automobile-traffic safety-insurance problem, perhaps such local experimentation is more than mere rhetoric. This problem contributed to the creation of the Department of Transportation which is now in the process of studying the whole automobile safety question.[84] In the last few years several comprehensive plans have been proposed and adopted; among them Massachusetts',[85] Connecticut's,[86] and New York's[87] are prominent. Significantly, none of these plans has been adopted in the state of its origin. Massachusetts, in August, 1970, became the first state

81. *Id.* at 211.
82. R. KENNEY, *supra* note 12, at 316 (emphasis by Mr. Kenney).
83. *Id.* at 315.
84. S. J. Res. 129, 91st Cong., 1st Sess. *Cong. Rec.* (1969).
85. R. KEETON & J. O'CONNELL, BASIC PROTECTION FOR THE TRAFFIC VICTIM (1965) [hereinafter cited as BASIC PROTECTION].
86. This is the Cotter Plan.
87. STATE OF NEW YORK INSURANCE DEPT., AUTOMOBILE INSURANCE . . . FOR WHOSE BENEFIT? (1970).

to adopt a variation of the no-fault type plan.[88] The conclusions of these studies have dramatically pointed up the need to improve the handling of claims from automobile accidents.[89] The FIGC can be reconciled with most of the proposals. Where there is conflict, adaptation of state programs should not prove too difficult.

Outside of the basic changes recommended by these plans, variations of seven devices are currently being used by individual states in an attempt to deal with compensating a victim who fails to find a financially responsible defendant. No one of these seven is an answer in itself, and even combinations of them do not alleviate the problem of the uncompensated victim. The majority concern themselves with company solvency.

The uninsured motorist provision is a typical provision in an automobile insurance policy.[90] Three states require it by law.[91] Other states allow it, unless rejected by the purchaser.[92] This clause generally provides that the insurer must pay any losses occurring to one of its insured in an accident with an uninsured motorist.[93] Depending upon how "accident" and "uninsured motorist" are defined, the clause has been more or less effective. Critically, from a solvent defendant point of view "uninsured motorist" should include one who has insurance with an insolvent company.

Three states have compulsory insurance.[94] Compulsory insurance is not the solution many would think—interstate travel plays havoc with such a plan.[95] Additionally, such programs often have limits that preclude adequate coverage of the costs of an accident; people may simply violate the law and drive without insurance.

Financial responsibility laws,[96] of two basic types,[97] are in

88. The Charlotte Observer, August 14, 1970, § A, at 1, col. 6.
89. *See* G. HALLMAN, UNSATISFIED JUDGMENT FUNDS 7 (1968). For an estimate of the staggering costs of auto accidents [hereinafter cited as G. HALLMAN].
90. *Id.* at 29 nn.14&15. At the end of 1967, 42 states had some form of uninsured motorist clauses; thirty-three states permit rejection of it. *Id.* n.15.
91. *Id.*
92. *Id.*
93. *Id.* at 28.
94. Massachusetts, New York, and North Carolina.
95. BASIC PROTECTION, *supra* note 85, at 77-102, particularly page 89 on the Massachusetts plan. (Compulsory liability insurance here is used in reference to private vehicles; nearly all states require it for common carrier.)
96. *Id.* at 102-09 and G. HALLMAN, *supra* note 89, at 28-34 give basic explanations of the varying plans.
97. BASIC PROTECTION, *supra* note 85, at 103-05. "Proof" type laws require demonstration of ability to meet future claims. "Security" type laws require

effect in most jurisdictions. The chief drawbacks of such laws are the "one bite" provision[98] and the fact that people do not waste time suing a judgment proof debtor to help the next man by requiring that the accident-causing party put up the required security.

Unsatisfied judgment funds[99] and assigned risk insurance[100] are two other approaches. There are the various impoundment laws, but a stored, wrecked vehicle seldom covers the cost of the accident. Motor vehicle liability security funds are extant in New York, New Jersey, and Maryland.[101] Other insurance may lessen the social costs; for example, health and accident insurance may lessen the out of pocket expenses of a victim injured by an uninsured motorist.

Development of these various approaches is not stifled by the FIGC. Indeed, exhaustion of such local remedies is required *before* the FIGC is allowed to pay. It would seem that enactment of the FIGC Act would be a welcome complement to state programs, since solvent companies are a necessary ingredient of all programs designed to protect the citizens of a state.

C. Other Considerations

The FIGC does seek to insure a private market in insurance. Another solution to insolvency would, however, be government insurance.[102] Generally, this is not favored by any substantial group at the present time. Increasing government participation in insurance as a social measure has occurred in certain other fields.[103] Other countries have experienced greater government participation in the insurance field itself and in the regulatory process,[104] but practically speaking, because of the nature of the development of casualty insurance in the United States, such a proposal is not at this time feasible or desirable.

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demonstration of ability to meet claims out of the first accident up to the statutory minimum. All states but Massachusetts have this provision now.

98. "One bite" provisions provide security for the second accident. The first victim often remains uncompensated under such a provision.

99. *See* G. HALLMAN, *supra* note 89.

100. G. HALLMAN, *supra* note 89, at 28. This complex area is mentioned merely as one method of meeting the problem of compensating victims by increasing the number of potentially nonresponsible defendants with insurance coverage.

101. *Id.* at 34-36.

102. *See* R. HENSLEY, *supra* note 77, at 211.

103. Government riot insurance is an example.

104. *See* ORGANIZATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, SUPERVISION OF PRIVATE INSURANCE IN EUROPE (1965).

Perhaps a federal guaranty scheme would enlarge the tools available to fight against criminal elements in insurance.[105] The stock dealing disclosure requirements would eliminate the ease of manipulation currently available.[106]

The creation of the FIGC may, however, have a substantial effect on small insurers, since the presumably stricter standards of the FIGC will be more of a problem for small insurers to meet. Many of these companies are at a decided disadvantage because they started with only a small amount of capital.[107] Largely for that reason, Vestal Lemmon, then president of the National Association of Independent Insurers, characterized this proposal as "more dangerous a threat to the preservation of state regulation and the future of the business than any other measure with which the business has ever been confronted."[108]

More equitable tax burdens are another possible effect of the FIGC. The present taxation of insurance companies is a patchwork because of the varying nature of the state plans. Possibly, more efficient management of reserves could be accomplished if all funds could be concentrated in one place and the requirement of state deposits were removed. Both of these considerations do, however, involve an expansion of the present plans for the FIGC.

D. Reaction of Involved Parties

Reaction to the proposal has been mixed in the insurance industry, among regulatory authorities, and among political circles. The National Association of Insurance Commissioners[109] is opposed to the plan.[110] Their opposition is primarily based on fear of federal domination of the regulation of insurance practices. They favor independent state guaranty funds.[111]

105. Recent scandals have pointed up the participation of criminal elements in insurance schemes. Because such scandals have often involved manipulation of companies in several states, jurisdiction over parties and enforcement of personal responsibility have been difficult to accomplish. *See* 1968 Hearings.

106. *See* Killen, *supra* note 70, at 10, 11, and 74 for a discussion of the manipulation of pink sheet values as a basis for a defrauding scheme.

107. *See* R. HENSLEY, *supra* note 77, at 48-52.

108. *National Underwriter,* May 5, 1967 at 1, col. 3.

109. The NAIC seeks: "To promote uniformity in legislation affecting insurance; to encourage uniformity in departmental rulings under the insurance laws of the several states; to disseminate information of value to insurance supervisory officials in the performance of their duties; to establish ways and means of fully protecting the interests of insurance policyholders of the various states, territories and insular possessions of the United States." From NATIONAL INSURANCE ORGANIZATIONS IN THE UNITED STATES AND CANADA 39 (R. Breitner ed. 1957) [hereinafter cited as ORGANIZATIONS].

110. N.Y. Times, Jan. 26, 1970, at 18, col. 3.

111. *See* 70 BEST'S REVIEW 80 (Property-Liability ed. Nov. 1969).

The American Mutual Insurance Alliance[112] and the National Association of Independent Insurors[113] also oppose it.[114] By contrast The American Insurance Association,[115] which writes 30% of all automobile insurance, favors the plan. This group is also on record as favoring the adoption of some form of no-fault system.[116]

The bill itself has had many sponsors in both houses of Congress, but action on the proposal will probably await the results of the study by the Department of Transportation.

IV. CONCLUSION

The Federal Insurance Guaranty Corporation proposal carries with it a certain degree of federal regulation. This is inevitable with any entity capable of making rules and regulations that say how an enterprise is to be conducted. The authority that determines the standards of an industry shapes that industry. Whether or not the degree of control that will come with the FIGC is desirable depends in large measure upon power allocations preferences and upon the need for nationwide control of insolvency. The FIGC does allow states to continue their regulatory programs; the states would have to exercise that option. In light of the developments since the McCarran Act, states would in all probability continue their programs of control and merely work the FIGC into the scheme.

The problem of insolvency is large. The present configuration of the industry makes interstate problems inevitable, since the reinsurance programs of companies almost always cut across state lines in seeking to further the basic principle of insurance of spreading the risk among a sufficiently large population so that the business is profitable. When all companies seek to achieve risk spreading through reinsurance, many companies are usually affected by a single company's failure. Given the high

112. *See* ORGANIZATIONS, *supra* note 109, at 7-8.
113. Consists of fire, casualty and surety insurers of every type. Their principal, common characteristic is that all consider themselves to be independents, that is, opposed to all forms of forced regimentation, particularly as to such matters as rates, rules, classifications and forms of coverage. To accomplish these aims the Association keeps abreast of legislative trends, administrative and judicial actions and cooperates with the industry organizations on matters of common interest.

ORGANIZATIONS, *supra* note 109, at 38-39.
114. N.Y. Times, Jan. 26, 1970, at 18, col. 3.
115. *See* ORGANIZATIONS, *supra* note 109, at 5.
116. N.Y. Times, Jan. 26, 1970, at 18, col. 3.

number of recent failures, some form of interstate cooperation is necessary. The FIGC should provide the compulsion to achieve the needed cooperation. The NAIC has not come forth with a solution that the states, through their political processes, have implemented. Therefore, the FIGC seems at present a worthy proposal that can make a lasting contribution to reducing the social costs of automobile accidents. The changes that the states would need to make in their regulatory schemes and the requisite amount of control that they would give up can be offset by the increased efficiency that the FIGC would provide. States could draw heavily on the reports of the FIGC. The representation that the states would have on the Advisory Board should serve as a check on the FIGC's preemption of the regulation of the field, such preemption being more of an imagined fear than a real one.

One of the chief values of the FIGC is that it guarantees policies and not systems of insurance. This is desirable so that the creative changes now being attempted to solve the many problems of a fault insurance system can proceed as states feel the need to alter the present system. Different state schemes can live within the penumbra of FIGC protection.

It is to be hoped that the Department of Transportation study, now being completed, will suggest further refinement in the structure and operation of the FIGC. The FIGC proposal can eliminate a portion of the complex automobile safety cost problem with only minor disruptions of the present system and with an ability to adapt to the future. Adoption of the Federal Insurance Guaranty Corporation proposal, or one substantially similar, is desirable and is recommended as a solution to the growing problem of insolvent insurance companies.

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