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Editorial
From The New York Times

Regulator Shopping

The financial crisis had no single cause. But everyone knows that regulatory failure played a role and that one of the biggest mistakes was to allow “regulatory shopping” — in which banks and other financial firms were permitted to choose their own regulator.

What resulted was a race to the bottom. Many firms switched at will among various overseers, in search of the loosest rules and laxest regulators.

And yet, legislation recently introduced in the House would allow insurance companies, currently regulated by the states, to opt for federal regulation instead — and, in general, if they don't like that, to switch back after a spell. If the bill were enacted, the race to the regulatory depths would continue, and the nation would be headed in exactly the wrong regulatory direction.

The rationale for the proposal — known as the optional federal charter — is as meritless as the proposal itself. Supporters of the bill, by Melissa Bean, Democrat of Illinois, and Ed Royce, Republican of California, say the bailout of the American International Group is evidence of the need for the bill. That doesn't compute.

The insurance businesses of A.I.G. did not falter during the financial crisis, and remain solvent and functional to this day. There are many problems with state regulation of insurance — it is inefficient for insurers and inconsistently applied by the states — but it has done a good job ensuring the safety and solvency of insurance operations, something that can't be said about federal bank regulation.

What failed at A.I.G. was its non-insurance business — specifically, the financial products unit, overseen by the federal Office of Thrift Supervision, arguably the weakest of all the federal bank regulators. A.I.G. was permitted to choose the thrift office as its non-insurance overseer in 1999, after it bought a small savings and loan.

Thus, A.I.G.'s bailout is not an indictment of state regulation of insurance. It is a vindication of it, because the insurance businesses weathered the crisis relatively unscathed. Nor is it an argument for a license to choose one's regulator, because regulator-shopping got A.I.G. the overseer least equipped to rein in its risky dealings.

The bill's proponents have also said that the federal government has a duty to oversee insurance companies because some have been offered bailout money in the past week. That is evidence, they claim, that insurers can threaten the financial system, necessitating federal oversight. But the Treasury Department said that the decision to grant money to insurers wasn't based on concerns about systemic risk, but rather was intended to boost investor confidence in healthy firms.

At play here is the power of the insurance industry that has clamored for federal — weaker — regulation for nearly a decade. The industry, and its Congressional supporters, are trying to use the current upheaval to advance a predetermined agenda.

The effort is disingenuous — and a shame. Insurance needs to be better regulated, especially with regard to consumer protections, to prevent discriminatory pricing and delays in payments, and to ensure availability and affordability of insurance. The financial crisis may have also revealed areas where a greater federal role is indeed called for, such as in bond insurance, which is not directly related to consumers and yet has a major impact on state and local economies. At best, insurance regulation would be reformed to allow for an interplay of state and federal regulation, such that each reinforces the other. As it is, the bill would pit one against the other.

Cooler heads in Congress and the Obama administration should stop the optional federal charter — and all forms of regulatory shopping — in their tracks.