



"Simplifying Regulation for Agents and Brokers..."



What problems is the OFC designed to address - The idea of offering insurance agencies and companies an Optional Federal Charter (OFC) as a regulatory alternative is in response to the lack of uniformity and efficiency in the current state regulatory system and an attempt to create a mechanism for improving the speed with which insurance products can be brought to market. Creating an OFC is also an attempt to bring the benefits of market economics to the insurance industry by allowing markets, not bureaucrats, to establish rate and product design. Specific problems addressed by our OFC proposal include the following:

Lack of Uniformity in State Regulation

The current system of regulation is composed of 56 separate jurisdictions, each distinctly different from the others. Allowing the option of being regulated by one unified federal scheme allows insurance entities and the consumers they serve to realize operational efficiencies that inevitably lead to product savings. (See Privacy example below)

Producer Licensing Duplication

The Gramm-Leach-Bliley Act (GLBA) attempted to mandate uniformity and reciprocity in the area of producer licensing. A year ago, the National Association of Insurance Commissioners (NAIC) was supposed to certify that it had met the conditions of GLBA's registered agent and broker provisions. To date, 41 states have passed some of the **reciprocity** provisions of the NAIC's Model Producer Licensing Act. But, many states are still not in compliance. Those that have been certified by NAIC still allow variances – extra requirements like fingerprint and background checks – before a non-resident license is granted. Failure here, sadly, is expected: the NAIC has said it will deliver uniform agent licensing regulations nationwide every year for over 132 years.

Product Innovation and Introduction Barriers

Whereas other financial services providers can introduce products to their markets as quickly as they can analyze and develop them, it is the rule, not the exception, that nationwide introduction of insurance products can be a two-year process. The different jurisdictions generally require prior approval of a product before they will allow it to be offered to consumers.

Even when all 56 jurisdictions approve a product for sale, the product's design can be significantly different from one jurisdiction to another. Because of this prior approval requirement, insurance companies are reluctant to allocate capital to new product design and instead must focus scarce resources on continuing to obtain approval for existing products.

Need for Federal Regulator

An Optional Federal Charter for insurers will provide a federal regulator to represent the insurance industry before Congress, the Administration and foreign officials. Individual state regulators and the association that represents them do not have the same stature or authority of a federal regulator and therefore cannot adequately fill this

void. The life insurance industry has an especially critical need for this federal insurance industry advocate as it increasingly faces tax law changes impacting the very nature of its business. A federal insurance regulator is also needed to implement new congressional mandates on life insurers in areas such as privacy, data security, and national security in a timely and uniform manner.

Rate Regulation

With the exception of life insurance products, insurance is generally subject to strict price controls to the detriment of consumers. For example, Massachusetts and New Jersey, two states with the most restrictive price controls, are also the two states with the fewest number of auto insurers than any other state. By contrast, Illinois and South Carolina, two states that have allowed the free market to set auto insurance rates, enjoy the most number of insurers willing to write policies in their state. This is not a coincidence.

Market Conduct Confusion

Expensive and duplicative Market Conduct regulations are a by-product of the multi-jurisdictional state regulatory regime. The General Accounting Office (GAO) has recently criticized this system for offering consumers little protection from fraud and insolvency while at the same time raising compliance costs for companies.

Few states are willing to rely on the market conduct examination results from other state's compliance reviews and the District of Columbia's current attempt to lead an effort for a single, unified privacy market conduct exam has failed; more than a dozen states have said they will not join the effort.

Non-uniform Privacy Regime

In response to GLBA's privacy standards, the NAIC unanimously adopted its model "Privacy of Consumer Financial and Health Information Regulation" in September 2000. Yet there is little uniformity nationwide. States have enacted and promulgated privacy laws and regulations that depart in numerous ways from both the GLBA and the NAIC model. This creates a costly patchwork of privacy obligations. Compounding the problem is a 20-year old NAIC insurance privacy model that remains the law in sixteen states and differs in scope and form from the more recent model.

The Consensus OFC Legislative Proposal's Key Elements - Seven years ago, ABIA began to advocate for the creation of an OFC and three years ago ABIA released its OFC legislative proposal. Within a year, the American Council of Life Insurers (ACLI) and the American Insurance Association (AIA) embraced the concept and developed their own legislative versions of the OFC. Since then, the three organizations have synthesized the separate proposals into a single consensus proposal, the key elements of which are:

Unified Federal Regulator

The proposal establishes a federal insurance office in the Treasury department that would be vested with the authority to charter national companies and agencies and to implement the statute governing their activities. This office, and the single appointed regulator responsible for its activities, would regulate solvency, market conduct and accounting of federally charter entities.

Unified Licensing Authority

The federal insurance regulator would be solely responsible for chartering and licensing federal insurance entities by line of business. Conversely, states would retain the ability to license insurance entities that wished to remain state governed institutions.

Rate and Form Deregulation

The proposal would not impose rate regulation on federally chartered companies nor would it allow the federal regulator to require prior approval of forms.

Federal Preemption

The proposal would rely on strong, federal preemption to create a regulatory framework based on a single set of federal rules, instead of a patchwork of multiple state rules, for those that elect the federal regulatory option.

McCarran-Ferguson Repeal

The OFC proposal would repeal the McCarran-Ferguson Act's anti-trust exemption for those entities that elect to operate under a federal charter and, thus, would subject them to regular Sherman Act restrictions.

Unified Guarantee Mechanism

The proposal relies on the continued operation of the state guarantee fund system and only resorts to a federal mechanism should an individual state's system not meet certain minimum requirements.

Safeguards State Premium Tax Revenue

The proposal relies on participants in the federal charter to shoulder the costs of the federal charter. Premium taxes, currently estimated at \$12 Billion annually, would continue to be collected by the states in which the premiums are drawn.

Product Speed to Market

The proposal would endow insurers with the same "authority" to engage in the business of insurance as banks have to engage in the business of banking and would implement a system of routine examination and filing requirements to monitor compliance with the law. Thus, a state system predicated upon "prior approval" of insurance products before they can be sold would, for nationally chartered insurers, become a system of "file and use" at least with respect to insurance products.

Why Optional Federal Chartering is Superior to Other Approaches - In an attempt to forestall OFC legislation, alternatives to the OFC and the current state regulatory system have surfaced. Two of the most prominent include a quasi-treaty arrangement offered by the NAIC and various alternatives for a system of federal standards.

State Approaches

The NAIC has drafted and state legislators, through their insurance forum known as NCOIL, have accepted a model for achieving uniformity – the Interstate Compact – from which states are free to withdraw, if in fact they choose to join in the first place. The Compact is, in essence, a treaty, but one that the states can repudiate at will. No one state need agree to all the treaty's provisions. States can participate in some sections of the treaty and withdraw from others. But most importantly, for the treaty to be successful, state legislatures must subordinate their right to regulate the business of insurance to the drafters of the Compact.

In addition, if the NAIC's recent Statement of Intent is a guidepost for when the states might be able to adopt uniform regulations, the earliest date by which the NAIC has pledged to adopt final versions of many of its various initiatives – as distinct from the date when all 56 jurisdictions enact them – is January 2008. Surely, enacting a compact, which addresses all the shortcomings in state regulation, will take much longer.

Federal Approaches

One competing scheme that is being discussed at the federal level is the creation of federal standards to be applied by the individual states. This concept could take two forms, neither of which is preferable to optional federal chartering.

On the one hand, federal standards could serve as minimum standards for the states, permitting states to layer further regulation on top of those mandated by the federal government. Under this scenario, federal standards would fail to achieve the uniformity and efficiency of regulation sought by ABIA and other advocates of optional federal chartering. In fact, minimum federal standards would only exacerbate the current patchwork of differing laws with which insurers and producers have to deal by adding another layer of regulation.

On the other hand, federal standards could be mandatory and exclusive. As such, the federal standards would not be an alternative to state regulation; they would replace state regulation. This alternative would intrude on the states to a much greater degree than an optional federal regulator, which would leave state regulation untouched and the state system to its own devices. Instead of creating regulatory alternatives brought about by an optional federal charter and the healthy dynamic such alternatives engender, mandatory federal standards would spell the demise of state regulation, a result the critics of optional federal chartering are trying to avoid.

Superior Example Set by the Dual Banking System - The conceptual origins for an Optional Federal Charter are rooted in the success of the dual banking system. Many of the structural elements of the consensus OFC proposal are drawn from this model.

Charter Choice has Existed for Over a Century

Dual chartering of banks has over a 130-year history in our nation. It was in 1863, after 80 years of solely state regulation, that the federal government began chartering and regulating banks. The National Bank Act signed that year did not replace the state system, as many people expected. It offered banks the choice of having a state or national charter.

Today, over 70 percent of banks currently operate under the state charter. In 2000, 152 new state banks began operations, compared to just 40 new national banks, continuing a trend that has persisted since 1985.

Dual Chartering Fosters Innovation

For over a century, allowing charter choice has compelled state and federal regulators to continually improve the characteristics of their charters, leading to the current wide array of products and services available to consumers.

Dual Chartering Fosters Better Financial Regulation

Providing a choice between regulators gives a broad perspective and guards against rigidity. It also promotes efficiency of operations and supervision.

