

How Will the Optional Federal Charter Impact You?

Written by Lois Kindle AgentsSalesJournal.com August 2007

For more than a century and a half, life insurance companies have supported exclusive state regulation of the insurance business. But as the needs of consumers changed over the years to include investments and asset management, life insurers began competing with banks and securities firms. Many in the industry now see the need for a new regulatory system called an optional federal charter (OFC).

Essentially, an optional federal charter would allow insurance companies and agents to choose between state-by-state or federal government regulation, depending on their needs and those of their customers.

To establish this option, S.40, The National Insurance Act of 2007, was introduced May 24 in the U.S. Senate by Sens. John Sununu and Tim Johnson. The bill would establish a dual-chartering regulatory system, similar to one that has regulated other financial institutions for more than 100 years.

The pros

Proponents of S.40 include the American Council of Life Insurers (ACLI), Agents for Change, The Council of Insurance Agents and Brokers, The Financial Services Forum, and the Financial Services Roundtable, which have formed the Optional Federal Charter Coalition.

They argue the federal option would provide insurance companies with more uniform and consistent laws, regulations, and consumer protections. It would also enhance competition, where banks and securities firms currently have a regulatory advantage because they are nationally chartered and can introduce products to market much faster. And the law could save money.

A study, "State Regulation of Life Insurers: Implications for Economic Efficiency and Financial Strength" by Dr. Steven Pottier of the University of Georgia, was recently conducted for the American Council of Life Insurers. In his report, Pottier estimated life insurance companies could save more than \$5.7 billion annually in compliance costs by dealing with a single regulator. Those savings ultimately could be passed on to consumers in the form of reduced premiums.

"(The ACLI) views regulatory reform — through OFC as well as state-based improvements — as a survival issue," said Frank Keating, president and CEO of ACLI. "Without regulatory modernization, America's life insurance companies will face an ongoing competitive disadvantage in the marketplace. Insurance producers will suffer the same fate as insurance companies if we cannot bring innovative products to market quickly enough to meet evolving consumer demands."

State insurance commissioners and their staff are not the problem, Keating said, adding that all are dedicated, hard-working professionals.

"The issue is systemic," he said. "It is very difficult and time-consuming to get 51 legislatures and 51 insurance departments to agree not only on a common set of

insurance laws, but on a common interpretation of those laws. The delays inherent in this system hamper our ability, and the ability of producers, to serve consumer needs.”

“Optional federal chartering recognizes the reality that life insurance is an interstate business and that the life insurance protection and retirement security needs of Americans do not vary from Maine to Hawaii and from Florida to Alaska,” Keating continued. “For life insurers that do business across all 50 states and the District of Columbia, having the option of a single national charter just makes common sense.”

The impact on agents

Some in the industry say agents could gain the most. Currently, producers who operate in more than one state must acquire multiple licenses and comply with a dizzying array of both licensing and continuing education requirements. When a customer moves to a state where their agent is not licensed, the agent is faced with the choice of losing the client’s business or acquiring a license to operate in that state.

Under an OFC, this would change.

“An OFC will allow agents to opt into a federal regulatory structure to receive one license to sell in 56 jurisdictions — 50 states, five territories, and the District of Columbia,” said Peter Ludgin, executive director of Agents for Change, a 4,000-member trade association of insurance agents and brokers. “This is optional. If producers are happy with the current system, absolutely nothing will change for them.”

Ludgin emphasized that other advantages for agents and brokers within the framework of an OFC include diminished amounts of time spent on licensing issues, speedier marketing of products to the public, additional products to offer the consumer at competitive rates, and improved customer service.

Agents for Change held a legislative conference in Washington, D.C. on June 5-6, where producers and brokers from across America visited Capitol Hill to demonstrate their support for OFC.

“There is no doubt that momentum on Capitol Hill is swinging in our favor,” stated Chairman Robert Poli in a news release following the conference. He said the group has met with more than 125 congressional offices during the past two years. “We are not advocating abolishment of the state-based insurance regulatory system nor would we support a federal system with weak consumer protections. We simply want to give producers the choice to opt into a modern federal regulatory system if it makes sense for their business models and their customers.”

The cons

Not everyone is convinced, though. The Independent Insurance Agents & Brokers of America (also known as the Big “I”), the National Association of Mutual Insurance Agencies (NAMIC), and the National Association of Professional Insurance Agents (PIA) do not support a federal regulatory system.

The position these organizations have taken is that while the state regulatory system is not perfect, it has worked for 150 years. They acknowledge some changes are needed but say adding a huge federal bureaucracy is not among them.

Leonard Brevik, executive vice president and CEO of the National Association of Professional Insurance Agents, has been one of the most vocal opponents of OFC.

While PIA welcomes the ongoing debate about insurance regulatory reform, it actively supports the state-based system and believes Congress should take a hands-off approach.

Brevik likens the issue to the fight between David and Goliath. "It's about the mega-banks and the mega-insurance companies versus Main Street," he said. Brevik believes the state system isn't broken; it simply needs modernization and improvement. Adding a federal bureaucracy would only hinder the process and create massive amounts of duplication. A good compromise, he said, would be interstate compacts.

Robert Detlefsen, vice president of public policy for NAMIC, is skeptical that OFC will be the cure-all, as many believe.

"That the current system ... is a dysfunctional mess is beyond dispute," he wrote in a January opinion piece written for the National Council on Compensation Insurance. But creating a National Insurance Office through S.40 might only make matters worse, he said.

In theory, the regulatory competition between two levels of government created by the OFC might work, Detlefsen added, but the reality could be quite different. On the plus side, that competition would undoubtedly spur state-based reforms while deterring federal regulators from launching their own market interventions, he said.

But the two dynamics could only occur if most insurers are able to switch charters at a relatively low cost.

Detlefsen contends that will not happen.

"Unfortunately, the cost to an insurer of adopting a federal charter is likely to be quite high, and switching back to a state charter could be even more expensive," he said.

According to Detlefsen, the dual state/federal system would benefit only the largest insurers, those who can easily afford the costs of switching. Such bias would result in an uneven playing field, leaving small to medium-sized insurers trapped in a system that isn't necessarily in their best interests, but they are unable to do anything about it.

'A new federal bureaucracy'

The Big "I" is the nation's oldest and largest national association of insurance agents and brokers. Founded in 1896, it represents more than 300,000 nationwide.

The IIABA opposes the new "one-size-fits-all" federal bureaucracy that would be created by S.40. IIABA supports, instead, targeted federal legislation to reform the state regulatory system. It, too, concedes there is a need for reform, but strongly asserts that OFC would generate a whole new set of problems for insurers, agents, and consumers.

The Big "I" agrees with other opposing organizations that local insurance regulation is best for consumers and the state system provides greater responsiveness to the needs of agents, brokers, and consumers alike. Some of the group's other assertions include:

- A dual state/federal regulatory system would confuse consumers and could create coverage gaps.

- Even though some licensing concerns might be addressed by the bill, additional regulatory burdens could result, making it harder for agents and brokers to efficiently represent their consumers.
- Many consumers would be left unprotected by the elimination or reduction of regulatory form review.
- State revenues would be negatively impacted by the loss of licensing fees, and the OFC could potentially tap into premium tax revenues for the states, which now totals around \$15 billion.
- Under the dual system that would be created by the OFC, federally chartered companies would contribute to existing state guaranty funds. However, if there were any solvency issues, the states would have no regulatory authority over companies under the federal charter.

“Targeted reform of the state-based system, such as the Nonadmitted and Reinsurance Reform Act (already) introduced in both the Senate and the House, is the appropriate remedy ... and is the only solution that has gained broad industry and bipartisan support,” said Charles E. Symington Jr., IIABA vice president for governmental affairs and federal regulations. “The Big ‘I’ hopes that industry participants will support this approach to much-needed reform that will benefit consumers now. Clearly, speed to market, agent and company licensing, market freedom, and other insurance regulatory concerns can be addressed efficiently and more expeditiously under this approach than under the creation of a new federal bureaucracy.”