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Insurance Regulation Reform: *The Optional Federal Charter*

Insurance regulation reform is getting attention on the Hill. We believe the 110th Congress is not likely to enact an optional federal charter (OFC), which would allow life and property and casualty insurers to choose either a state or federal regulator. However this issue is gaining momentum and we expect hearings in the coming months. These hearings would set the groundwork for a more concerted effort to enact an optional federal charter after the 2008 elections. In addition, we believe the odds favor Congress repealing the McCarran-Ferguson Act, which would open the door to some federal insurance oversight.

What the Optional Federal Charter Means for Insurers

- An option federal charter could be a boon to insurers. One industry study estimated that insurers would decrease their costs by \$5.7 billion a year. No longer would insurers need to deal with multiple state regulators or a duplicative approval process that often can delay product launches for a year or more.

Status of OFC Legislation

- In the Senate, Sens. John Sununu (R. N.H.) and Tim Johnson (D-S.D.) already have introduced an optional federal charter bill. On the House side, Rep. Ed Royce (R-Calif.) plans to introduce a bill shortly while House Financial Services Capital Markets Subcommittee Chair Paul Kanjorski (D-Pa.) intends to hold a hearing in the coming weeks on the optional federal charter.

Primer on Optional Federal Charter

As we expect the optional federal charter to gain more and more attention in the coming month, we decided to offer this primer that provides background on the issue and describes the key players fighting for and against the optional federal charter.

Unlike in banking, there is not a federal insurance regulator. An insurer must adhere to the rules of each state where it conducts business. An insurance commission for each state is responsible for industry oversight. The National Association of Insurance Commissioners (NAIC) is the regulatory support organization for state commissioners. Its role is to develop best practices and uniform polices, but it does not have any enforcement authority over state regulators.

With the Optional Federal Charter, insurers could choose either to remain in the state system or attain a federal license valid in all 56 U.S. insurance jurisdictions. An Office of National Insurance (ONI) would be responsible for the oversight of insurers under the federal charter. It would be located within the Treasury Department, and headed by an appointed Commissioner of National Insurance. The national commissioner would have authority over federally licensed insurers.

Arguments supporting an optional federal charter include:

- **More cost-efficient for major insurers.** Major insurers believe a federal charter would significantly reduce regulatory costs for the industry. Besides direct regulatory fees, many have also become frustrated with indirect costs from state regulation, such as delays when launching national or multi-state insurance products and lack of uniformity across state regulatory procedures.
- **Fed oversight would be better equipped to handle disastrous events.** Congress and the regulators would be better-equipped to deal with unexpected crises (*i.e.* terrorism and natural disasters) because the federal government has more resources.
- **Portions of the insurance market are becoming increasingly national.** This is especially true for life insurers because they tend not to consider geographic differences when developing products. OFC would allow companies to choose the most suitable regulatory approach for their operation.

Who is advocating for an optional federal charter?

- **Optional Federal Charter Coalition.** Group consists of 135 insurers, banks, and trade associations. Members include *New York Life Insurance*, as well as the Financial Services Roundtable and the American Bankers Insurance Association (insurance arm of ABA), both with a solid lobbying presence. (See Table I for a list of all companies that are part of the coalition.)
- **Banks.** Banks already operate under a dual regulatory system and have the ability to market insurance products. In recent years, bank insurance sales are growing and becoming more profitable. Many banks want the simplicity of having a single regulator rather than multiple state regulators.
- **Life Insurers.** Some life insurers support OFC legislation. It is more cost efficient for some large insurers to operate under a federal charter because their products are more national in scope. Also, life insurers with fewer resources, who are looking to expand business, would have an easier time complying with regulations under a federal charter.
- **Property and Casualty Insurers.** Insurers writing business property/liable insurance, malpractice and worker’s compensation, or larger, global insurers favor a single set of rules.
- **Smaller Health Insurers.** Many health insurers already have some degree of federal oversight and, therefore, typically favor an optional federal charter.

Related Legislation for Insurance Reform	
McCarran-Ferguson Act, 15 U.S.C. 20 of 1945	
<ul style="list-style-type: none"> • Insurers are subject to “effective” insurance regulation by the states • Provides limited federal antitrust exemption for the insurance industry 	
The Insurance Industry Competition Act of 2007	
<ul style="list-style-type: none"> • Repeals the state insurance regulation and antitrust provisions of the 1945 McCarran-Ferguson Act • 2005’s Hurricane Katrina invoked recent efforts by lawmakers to repeal the Act due to poor treatment of victims’ insurance claims 	
National Insurance Act of 2007 (NIA)	
<ul style="list-style-type: none"> • The legislation allows life and property and casualty insurers the option of federal charters • Insurers not opting for federal charter would continue to follow state regulation • An Office of National Insurance (ONI) is established within the Treasury Dept. and is headed by a Commissioner of National Insurance 	

Source: SGC.

Who is opposing an optional federal charter

- **Coalition Opposed to a Federal Insurance Regulator.** Group consists of insurers and trade associations. Members include *AFLAC* and the Independent Insurance Agents & Brokers (Big “I”), which have the second and third largest PACs in the industry, respectively.
- **State Regulatory and Legislative Groups.** States oppose an optional federal charter and fear loss of regulatory authority and state tax revenue.
- **Consumer Organizations.** Groups fear opting for a federal charter would undermine consumer protections; specifically in property and casualty insurance where geographic regions would play a large role in coverage.
- **Smaller Life Insurers.** Insurers that typically serve regional markets tend to be opposed to an OFC as they would gain little from a federal charter. They also do not want to make it easier for national rivals to enter their markets.
- **Some Property and Casualty Insurers.** Industry is split. Some are against reform because of the potential administrative headache created by a two-tiered system.
- **Large Health Insurers.** The current system makes it harder for smaller health insurers to expand into additional states. That gives large insurers an advantage, which is why some oppose reform.

We provide more details on the key players for and against an optional federal charter in Table I.

Repealing the McCarran-Ferguson Act

We believe odds are increasing that the 110th Congress will repeal the McCarran-Ferguson Act, which exempts insurance from most federal oversight. Senate Judiciary Committee Chairman Patrick Leahy (D-Vt.) introduced legislation which would remove the antitrust exemption for insurance. This would allow the Federal Trade Commission additional oversight and power to investigate the insurance market. Also, insurers would not be able to collaborate as freely with other insurers as they do under state regulation. These collaborations include: sharing customer claims information, developing common insurance forms, and creating pools for larger financial risk.

Repealing the McCarran-Ferguson Act would create a federal presence in insurance regulation, which some believe could open the door for the 111th Congress to enact an optional federal charter.

Table I

Positions on Optional Federal Charter for Insurance	
Optional Federal Charter Coalition	<ul style="list-style-type: none"> • Companies include: <i>AIG, Allstate, AXA Financial, Bank of America, CapitalOne, CIT Group, Fidelity & Guaranty, First Horizon, Hibernia, HSBC, Huntington, ING, JPMorgan Chase, Mellon Financial, New York Life Insurance, PNC, Prudential, The Hartford Group, and Wells Fargo.</i> • Trade Groups include: <i>Agents for Change, American Bankers Association, American Bankers Insurance Association, American Council of Life Insurers, American Insurance Association, Council of Insurance Agents and Brokers, Financial Services Forum, and Financial Services Roundtable.</i> • Views state regulation as a burden and inefficient for cos. whose interests are national in scope.
Coalition Opposed to a Federal Insurance Regulator	<ul style="list-style-type: none"> • Members include: <i>Independent Insurance Agents and Brokers of America, AFLAC, Jackson National Life Insurance Company, the National Association of Mutual Insurance Companies, the National Alliance of Life Companies, and the National Association of Professional Insurance Agents.</i> • Views that comprehensive reform is not needed in regards to insurance regulation.
<i>Banks</i>	
American Bankers Insurance Association (ABIA) http://www.aba.com/ABIA	<ul style="list-style-type: none"> • Optional chartering has worked well in the banking industry, and there is no reason to believe it could not work well in the insurance industry. • Developed its own “blueprint” for insurance regulatory reform patterned after the dual banking system. • Joined forces with ACLI and AIA to develop a common optional federal chartering proposal.
The Financial Services Roundtable (FSR) http://www.fsround.org	<ul style="list-style-type: none"> • Strong support for the legislation introduced to create an optional federal charter to regulate the manufacture and sale of insurance products. • Views [OFC] as the single most important piece of financial services-related legislation that Congress would consider in the coming years.
<i>Life Insurance</i>	
American Council of Life Insurers (ACLI) http://www.acli.com	<ul style="list-style-type: none"> • Strongly supports the creation of an optional national regulator for insurers, in which life insurers would have the option of either federal or state regulation. • Continues to work closely with NAIC to make the current state-based system of life insurance regulation more efficient.
National Alliance of Life Companies (NALC) http://www.nalc.net	<ul style="list-style-type: none"> • Supports fair and effective regulation of the life and health insurance business, whether it comes from the states or from Congress. • Ask that any OFC proposals considered by Congress not exempt smaller insurers.

<i>Property and Casualty Insurance</i>	
American Insurance Association (AIA) http://www.aiadc.org	<ul style="list-style-type: none"> • Not excluding optional federal charter in the interest of considering all viable regulatory options. • Deal with many companies that would choose to remain in a state-based regulatory environment, likes alternative to state regulation, but not a replacement for the state-based system.
Reinsurance Association of America (RAA) http://www.reinsurance.org	<ul style="list-style-type: none"> • An appropriate reinsurance regulatory structure should include a single regulator for reinsurance with national regulatory oversight to achieve uniformity of regulation. • Advocating the option of a modified optional federal charter for reinsurance, allowing a reinsurer to choose between: (1) single federal regulator, (2) single state regulator, (3) or remain in the current 50-state system. • The RAA is joining the Optional Federal Charter Coalition.
Alliance of American Insurers (AAI) http://www.allianceai.org	<ul style="list-style-type: none"> • Lawmakers should grant limited antitrust exemption granted under the McCarran-Ferguson Act for insurance. • Repealing the [antitrust] exemption would harm state markets, especially in recovering markets in coastal areas.
Property Casualty Insurers Association of America (PCIAA) http://www.pciaa.net/	<ul style="list-style-type: none"> • The limited exemption that allows insurers to share loss data promotes competition in the marketplace by putting small and medium-sized companies on a level playing field with much larger competitors. • [Anti-trust exemption] creates efficiencies for insurers that translate into savings and choice for insurance buyers.
National Association of Mutual Insurance Companies (NAMIC) http://www.namic.org	<ul style="list-style-type: none"> • Opposes federal regulation of insurance or an optional federal charter. • Supports reforming the state-based system of insurance regulation through legislation in the state capitals. • An optional federal charter would usurp states' rights...the states have done nothing to warrant a federal takeover of state regulation of the property/casualty business.
<i>Health Insurance</i>	
American Association of Health Plan (AAHP) http://www.aahp.org	<ul style="list-style-type: none"> • The federal government can have a significant role in assisting the states to become more efficient and effective in their approach to regulation. • American Association of Health Plans (AAHP), and the Health Insurance Association of America (HIAA), have merged.
<i>State Regulatory/Legislative Groups</i>	
National Association of Insurance Commissioners (NAIC) http://www.naic.org	<ul style="list-style-type: none"> • NAIC members have modernized the state system across the regulatory spectrum to implement multi-state platforms and uniform applications. • A bifurcated regulatory regime with redundant and overlapping responsibilities would result in policyholder confusion, market uncertainty, and other unintended consequences. • Congress should reject the notion of a federal insurance regime.

<p>American Legislative Exchange Council (ALEC) http://www.alec.org</p>	<ul style="list-style-type: none"> • The federal government should not be permitted to preempt state legislatures in the regulation of health insurers. • The state-based regulatory schemes have served the interests of the public well, without unnecessary interference by the federal government. • The creation of a new federal system of regulation for health insurance would be inefficient, unnecessary, not cost-effective and further burden the health care delivery system.
<p>National Governors Association (NGA) http://www.nga.org</p>	<ul style="list-style-type: none"> • Federal law should not preempt or undermine this state authority, including allowing federal charters or congressional mandates that impose national standards to implement in the states. • [Congress] should continue to recognize the successful role of states as financial services regulators and particularly as the functional regulators of insurance and securities products.
Agent/Broker Associations	
<p>Council of Insurance Agents and Brokers (CIAB) http://www.ciab.com</p>	<ul style="list-style-type: none"> • We endorse this [OFC] legislation for its voluntary nature – voluntary for companies and as well as consumers. • The bill provides real choice for all participants in the insurance marketplace.
<p>National Association of Insurance and Financial Advisors (NAIFA) http://www.naifa.org</p>	<ul style="list-style-type: none"> • Not ready to take a position with regard to the National Insurance Act. • Supports efforts to streamline agent licensing requirements so that the rules do not vary from state-to-state. • Supports efforts to improve the speed at which life insurance and related products enter the national marketplace.
<p>Independent Insurance Agents of America (IIAA) http://www.iaaa.org</p>	<ul style="list-style-type: none"> • Opposes legislation which would create an optional federal charter. • Strongly supports targeted federal legislation, or “federal tools,” to reform the current state-based regulatory system without creating a federal regulator or “optional” federal charter.
<p>National Association of Professional Insurance Agents (PIA) http://www.pianet.com</p>	<ul style="list-style-type: none"> • Opposes all proposals calling for Optional Federal Charters (OFC) for insurance. • Opposes the Insurance Industry Competition Act of 2007. • Supports the McCarran-Ferguson Act and oppose its repeal.
Consumer Group	
<p>Consumer Federation of America</p>	<ul style="list-style-type: none"> • Strongly oppose an optional federal charter, where the regulated, at its sole discretion, gets to pick its regulator. It is regulatory arbitrage that would undermine needed consumer protections. • Represent consumer community and strongly against optional federal charters.

Source: SGC; Web sites provided within chart.

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