

Formula 51

An Optional Federal Charter Update

TO MOVIEGOERS, IT'S THE NAME OF THE LATEST SAMUEL JACKSON action flick. But for proponents of an optional federal insurance charter, "Formula 51" just might be an accurate description of the complexity inherent in the current state-level insurance regulatory system. For more than a century now, insurance has been one of the few large industries to weather federalization of regulatory oversight with a sole state-level system still intact. If federal charter supporters get their way, that era, for better or worse, will draw to a close.

The National Association of Insurance Commissioners (NAIC) has been the only governing body of the insurance industry since 1871. But against the backdrop of insurer insolvencies in the 1980s, and demands for a more efficient and competitive insurance market in the 1990s, calls for reform have prompted examination of a possible dual state and federal regulatory system.

A crucial event during this period was the passage of the Financial Services Modernization Act in 1999. Along with allowing banks and insurers to dip into each other's business, the act left regulation of insurance to the states but required a push toward uniform agent licensing laws or reciprocity agreements. The argument is that as financial services are merged under the umbrella of large conglomerates, it seems logical that the regulations governing those services should be merged and harmonized as well.

Combined with National Association of Registered Agents and Brokers reciprocity agreements, the first phase of a standardization effort began to provide insurers with an efficient marketplace that would eventually lead to increased competition. This transition essentially mirrored the environment of banking regulation, and forced the NAIC to implement the mandated reforms and examine its own reforms in the hope of streamlining the regulatory process and preventing further calls for federalization.

Despite the efforts of the NAIC to reform the insurance industry, many continue to argue that increased competition and efficiency are possible only through an optional federal charter. Opponents contend, however, that

the NAIC's interstate compact, which addresses coordination efforts between the states regarding certain insurance products, represents the first of several steps to coordinate at a state level, negating the need for a federal charter.

Dual Regulation

Clearly, the two sides are firmly entrenched, but which view an organization supports is as much a factor of products as it is of politics. Different lines of insurance would adapt to a federalized system in different ways. The nature and characteristics of property and casualty insurance, for example, vary more from state to state than, say, life insurance. Therefore, certain products and the companies that carry them might benefit more under the oversight of 51 geographically and socially specialized authorities, as opposed to one centralized, federal authority.

Organizations also understand, though, that products alone shouldn't be the sole motivation for choosing a system of oversight. In the proposed dual regulatory environment, an organization's size and its business processes also become factors in this decision. The intuitive choice of answering to one feder-

al body isn't necessarily the solution for small insurers who conduct business in only a single state, or a handful of states, and have streamlined their own internal processes for operating in that environment.

Conversely, large insurers with multiple lines operating nationally and internationally, and national banks accustomed to answering to one regulatory body, will benefit from the one-stop shopping of a federal insurance charter. Likewise, large foreign insurers looking to operate within the United States will welcome the opportunity to opt out of the multiple authority system as well as the cost, complexity, and inefficiency that, they argue, come along with it.

States have argued that they stand to lose tax revenues



ETHAN SONNICHSEN IS POLICY ANALYST FOR FINANCIAL REPORTING AT THE AMERICAN ACADEMY OF ACTUARIES IN WASHINGTON.

and jobs in the face of an optional federal charter. While certain federal charter proposals have addressed some of these concerns by prohibiting federal pre-emption of certain state-level regulatory services, other concerns still remain. Despite these arguments, the optional federal charter bandwagon rolls on, and for proponents, all that should remain to be determined is the language and scope of that option.

Narrowed Choice

Until recently, there were four main federal charter proposals receiving most of the attention. Three of the proposals emerged from within banking or insurance industry groups, and the fourth is proposed legislation from Sen. Charles Schumer (D-N.Y.). An analysis of each proposal is beyond the scope of this article and my abilities, but the American Academy of Actuaries will be finalizing a monograph in the coming months that compares the proposals with a particular focus on the impact each will have on the

actuarial profession as a whole. There is, however, one development that deserves some mention.

The three individual industry proposals, offered initially by the American Council of Life Insurers, the American Bankers Insurance Association (an affiliate of the American Bankers Association), and the American Insurance Association, are being scrapped for a combined proposal that these groups will be releasing through their alliance, the Financial Services Coordinating Council. This consensus proposal hasn't yet been released, so its language and similarity to the individual proposals are uncertain. However, this action signals a determined and unified effort by those most involved with the federal charter issue, up to this point, to design a dual regulatory system that benefits the broadest range of users.

While organizations and industry groups appear to be coordinating their efforts and solidifying their positions, legislative attention, for a host of reasons,

has been focused elsewhere. After holding several hearings in June to examine the possibility of legislation mandating a federal charter, Congress has essentially set aside the issue in the shuffle of a changing legislative agenda. Staff members of the House Financial Services Committee have expressed to Academy staff that optional federal charter legislation will likely be an important issue if state-level reforms are found to be inadequate, but when it will be addressed, and in what form, is still a matter of conjecture.

Risk Factor

In a sense, with the industry taking the lead in reforming itself at the state level, Congress is content to focus energies elsewhere for the time being, knowing legislative action may still be necessary despite the states' efforts. To be fair, Congress is busy with more urgent matters such as economic revitalization, homeland security, and the ever-present possibility of war with Iraq.

Even the congressional subcommittees that handle banking and insurance issues are involved with more pressing concerns, including the creation of a federal terrorism insurance backstop. The impact of the Sept. 11 terrorist attacks, and more recently the impact of corporate accounting scandals, has consumed whatever energies lawmakers might otherwise have applied to the federal charter debate.

Even so, there's reason to believe that Congress won't leave this issue on the back burner for much longer. Congress is exquisitely sensitive to fluctuations in economic progress. Recent attention on a federal terrorism insurance backstop, if nothing else, illustrates to the public, as well as members of Congress, the symbiotic relationship between economic strength and confidence and the insurance industry. Now more than ever, risk is a factor of doing business, and the creation of laws governing those who manage that risk is a responsibility Congress doesn't take lightly. Proponents of a federal charter hope that lawmakers will acknowledge that responsibility and bear its burden next year as the 108th Congress commences. ●

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