

An hourglass-shaped graphic with a globe inside. The top bulb is dark blue, and the bottom bulb is light blue. The globe is a light blue color with darker blue outlines for continents. The hourglass is centered on the page.

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Report RL34286

*Modernizing Insurance Regulation: Optional Federal Charter  
Legislation*

Baird Webel, Government and Finance Division

December 14, 2007

**Abstract.** Optional Federal Charter (OFC) legislation was first introduced in the 107th Congress, with bills being introduced in the 109th and 110th Congresses as well. Specifics of OFC legislation can vary widely, but the common thread is the creation of a dual regulatory system, inspired by the current banking regulatory system. OFC bills generally would create a federal insurance regulator that would operate concurrently with the present state system. Insurers would be able to choose whether to take out a federal charter, which would exempt them from most state insurance regulations, or to continue under a state charter and the 50 state system of insurance regulation. Given the greater uniformity of life insurance products and the greater competition faced by life insurers, some have suggested the possibility of OFC legislation that would apply only to life insurers, but no such bills have been introduced.

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# Insurance Regulation: Optional Federal Charter Legislation

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December 14, 2007

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**CRS Report for Congress**

*Prepared for Members and Committees of Congress*

## Summary

Insurance is one of three primary pillars of the financial services industry. Unlike the other two, banks and securities, insurance is primarily regulated at the state, rather than federal, level. The primacy of state regulation dates back to 1868 when the Supreme Court found in *Paul v. Virginia* (75 U.S. (8 Wall.) 168 (1868)) that insurance did not constitute interstate commerce, and thus did not fall under the powers granted the federal government in the Constitution. In 1944, however, the Court cast doubt on this finding in *United States v. South-Eastern Underwriters Association* (322 U.S. 533 (1944)). Preferring to leave the state regulatory system intact in the aftermath of this decision, Congress enacted the McCarran-Ferguson Act of 1945 (P.L. 79-15, 59 Stat. 33), which reaffirmed the states as principal regulators of insurance. Over the years since 1945, congressional interest in the possibility of repealing McCarran-Ferguson and reclaiming authority over insurance regulation has waxed and waned.

In recent years, particularly since the Gramm-Leach Bliley Act of 1999 (GLBA, P.L. 106-102, 113 Stat. 1338), the financial services industry has seen increased competition between U.S. banks, insurers, and securities firms and on the global scale. Complaints that the 50 state regulatory system puts insurers at a competitive disadvantage in the marketplace have been rising. Whereas the insurance industry had previously been united in preferring the state regulatory system, it has now splintered, with larger insurers tending to argue for a federal system and smaller insurers tending to favor the state system.

Some Members of Congress have responded since the 107<sup>th</sup> Congress with different proposals ranging from a complete federalization of the interstate insurance industry, to leaving the state system intact with limited federal standards and preemptions. The most common proposal has been for an Optional Federal Charter (OFC) for the insurance industry. This idea borrows the idea of a dual regulatory system from the banking system. Both the states and the federal government would offer a chartering system for insurers, with the insurers having the choice between the two. The proposed National Insurance Act of 2007 (S. 40 and H.R. 3200) is currently the only OFC legislation offered in the first session of the 110<sup>th</sup> Congress.

Proponents of OFC legislation typically cite the efficiencies that could be gained from a uniform system, along with the ability of a federal regulator to better address the complexities of the current insurance market and the need for a single federal voice for the insurance industry in international negotiations. Opponents of OFC legislation are typically concerned with the inability of a federal regulator to take into account local conditions, the lack of consumer service that would result from a faraway bureaucracy in Washington, DC, and the overall deregulation contained in some of the OFC proposals. This report offers a brief analysis of the forces prompting OFC legislation, followed by a discussion of the arguments for and against an OFC, and summaries of various OFC legislation that has been proposed. It will be updated as legislative events warrant.

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## Background

Insurance is one of three pillars of the financial services industry. Unlike the other two, banks and securities, insurance is primarily regulated at the state, rather than federal, level. The primacy of state regulation dates back to 1868 when the Supreme Court found that insurance did not constitute interstate commerce, and thus did not fall under the powers granted the federal government in the Constitution.<sup>1</sup> In 1944, however, the Court cast doubt on this finding.<sup>2</sup> Preferring to leave the state regulatory system intact in the aftermath of this decision, Congress enacted the McCarran-Ferguson Act of 1945,<sup>3</sup> which reaffirmed the states as principal regulators of insurance. Over the years since 1945, congressional interest in the possibility of repealing McCarran-Ferguson and reclaiming authority over insurance regulation has waxed and waned.

In 1974, Congress enacted the the Employee Retirement Income Security Act<sup>4</sup> (ERISA) preempting state laws governing many health benefit plans offered by employers, thus essentially federalizing much of the regulation of health insurance. In 1980, the Congress curtailed the authority of the Federal Trade Commission (FTC) to investigate the insurance industry, reducing a small avenue of federal oversight on insurance.<sup>5</sup> In the early 1990s, a bill<sup>6</sup> to repeal the limited antitrust exemption granted insurers in McCarran-Ferguson, and thus expand federal oversight of insurance, was reported out of committee in the House, but never reached the House floor. In 1999, Congress enacted the Gramm-Leach-Bliley Act<sup>7</sup> (GLBA), which specifically reaffirmed the states as the functional regulators of insurance.

GLBA may have statutorily reaffirmed the primacy of state regulation of insurance, but it also unleashed market forces that were already encouraging a greater federal role. GLBA removed legal barriers between securities, banks, and insurers, which, along with improved technology, has been an important factor in creating more direct competition among the three groups. Many financial products have converged, so that products with similar economic outcomes may be available from different financial services firms with dramatically different regulators. Insurers face 50 different state regulators and state laws, many of which differ on some particulars of insurance regulation. This has led to industry complaints of overlapping, and sometimes contradictory, regulatory edicts driving up the cost of compliance and increasing the time necessary to bring new products to market. These complaints existed prior to GLBA, but the insurance industry generally resisted federalization of insurance regulation at the time. Facing a new world of competition, however, the industry split, with larger insurers tending to favor some form of federal regulation, and smaller insurers tending to favor a continuation of the state regulatory system. Life insurers tend to more directly compete with banks and securities firms, so they tend to favor some form of federal charter more than property/casualty insurers.

Some Members of Congress have responded to the changing environment in the financial services industry with a variety of legislation. In the 108<sup>th</sup> Congress, Senator Ernest Hollings

<sup>1</sup> *Paul v. Virginia* (75 U.S. (8 Wall.) 168 (1868)).

<sup>2</sup> *United States v. South-Eastern Underwriters Association* (322 U.S. 533 (1944)).

<sup>3</sup> P.L. 79-15, 59 Stat. 33,15 U.S.C. Sec. 1011 *et seq.*

<sup>4</sup> P.L. 93-406, 88 Stat. 829.

<sup>5</sup> The Federal Trade Commission Improvement Act of 1980, P.L. 96-252, 94 Stat. 374.

<sup>6</sup> H.R. 9, The Insurance Competitive Pricing Act of 1994, by Representative Jack Brooks.

<sup>7</sup> P.L. 106-102, 113 Stat. 1338.

introduced S. 1373 to create a mandatory federal charter for insurance. In the 108<sup>th</sup> and 109<sup>th</sup> Congresses, Representative Richard Baker drafted, but never introduced, the SMART Act<sup>8</sup> that would have left the states the primary regulators, but harmonized the system through various federal preemptions. The most consistent response has been the introduction of legislation calling for an Optional Federal Charter (OFC) for insurance.

OFC legislation was first introduced in the 107<sup>th</sup> Congress, with bills being introduced in the 109<sup>th</sup> and 110<sup>th</sup> Congresses as well. Specifics of OFC legislation can vary widely, but the common thread is the creation of a dual regulatory system, inspired by the current banking regulatory system. OFC bills generally would create a federal insurance regulator that would operate concurrently with the present state system. Insurers would be able to choose whether to take out a federal charter, which would exempt them from most state insurance regulations, or to continue under a state charter and the 50 state system of insurance regulation. Given the greater uniformity of life insurance products and the greater competition faced by life insurers, some have suggested the possibility of OFC legislation that would apply only to life insurers, but no such bills have been introduced.

## **Arguments for a Dual Regulatory System**

In addition to the principal argument that the regulation of insurance companies needs to be modernized at the federal level to make insurers more competitive with other federally regulated financial institutions in the post-GLBA environment, other arguments advanced for dual chartering include the following:

- The need to have a federal insurance regulator who could have a knowledgeable voice and be an insurance advocate in Washington, DC.
- The success of the Comptroller of the Currency (OCC) in expanding bank products through preemption of state laws.
- The need for “speed to market” for product approval so insurers will not be at a distinct disadvantage in product creation and delivery.
- The creation of a more accommodating regulatory environment as a result of competition between federal and state regulators, as in the case of banks.
- The ability to achieve national treatment, so that a single charter would allow insurers to do business in all states and avoid higher costs of state regulation due to the need to comply with 50 state regulators.
- The difficulty insurers have in expanding abroad without a regulator at the national level.
- Greater supply of insurance and lower cost to consumers as insurance companies are forced to compete on a national scale.

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<sup>8</sup> This act was the subject of a June 16, 2005, hearing in the House Financial Services Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises entitled “SMART Insurance Reform.”

## Arguments Against a Dual System and for State Regulation

The arguments of those who oppose any federal regulation of insurance companies, but prefer that the state insurance regulatory system be maintained, include the following:

- State insurance regulators' unique knowledge of local markets and conditions.
- The flexibility and adaptability of state regulation to local conditions.
- The diversity of state regulation, which reduces the impact of bad regulation and promotes innovation and good regulation.
- The reduced risk that a regulator who pursues bad policies will be able to affect large numbers of insurers.
- The existence of strong incentives, such as direct election, for state regulators to do the job effectively at the state level.
- The danger of a costly overlay of a new federal bureaucracy.
- Fiscal damage to the states should state premium taxes be reduced by the federal system.<sup>9</sup>
- The fragmentation of the overall insurance regulatory system that could result from dual chartering and state/federal oversight.
- The possibility of a “race to the bottom” as state and federal regulators compete to give insurers more favorable treatment and thus secure greater oversight authority and budget.

In the abstract, the OFC question could be simply about the “who” of regulation. Should it be the federal government, the states, or some combination of the two? In practice, however, OFC legislation has had much to say about the “how” of regulation. Should the government continue the same fine degree of industry oversight that it has practiced in the past? The OFC bills that have been introduced to this point have tended to answer the latter question negatively—the federal regulator that they would create would exercise less regulatory oversight than most state regulators. This deregulatory aspect of past and present OFC bills can be as great a source of controversy as the introduction of federal regulation itself.

## Optional Federal Chartering Legislation

### 110<sup>th</sup> Congress

#### The National Insurance Act of 2007

Senators John Sununu and Tim Johnson introduced S. 40 on May 24, 2007, while Representatives Melissa Bean and Edward Royce introduced H.R. 3200 on July 26, 2007. The bills have been

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<sup>9</sup> Premium taxes on insurance are a significant source of revenue for states' general funds. In total, states collected approximately \$15.4 billion in premium taxes, approximately 2.2% of state tax revenues. “State Government Tax Collections” U.S. Census website <http://www.census.gov/govs/statetax/0600usstax.htm>, visited on Dec. 10, 2007.

referred to the relevant committees (Senate Banking, Housing, and Urban Affairs, House Financial Services, and House Judiciary), and neither has been the specific subject of hearings or markups. Two general hearings on insurance regulatory reform, however, were held by the House Financial Services Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises in October 2007, and the possibility of an optional federal charter was a major topic of discussion in the subcommittee. Chairman Paul Kanjorski indicated in his opening statement of the October 3 hearing<sup>10</sup> that there would be a series of hearings on insurance reform, but further hearings have not been scheduled at this point.

S. 40 and H.R. 3200 are very similar, but not identical bills. Both would create the option of a federal charter for the insurance industry, including insurers, insurance agencies, and independent insurance producers. The bills would create a federal regulatory and supervisory apparatus, including an Office of National Insurance and a National Insurance Commissioner. This federal regulator would generally be overseen by the Secretary of the Treasury, but the secretary would be forbidden from interfering in specific matters before the commissioner. The budget for the office would be paid for by fees and assessments on insurers. The commissioner would be appointed by the President, and confirmed by the Senate for a five-year term. Holders of a national license would be exempt from most state insurance laws. Thus, nationally licensed insurers, agencies, and producers would be able to operate in the entire United States without fulfilling the requirements of the 50 states' insurance laws. Some significant aspects of the bills include the following:<sup>11</sup>

- The federal system would apply to property/casualty and life insurance, except for title insurance and including surplus lines insurance.<sup>12</sup>
- Rate regulation would not be applicable to national insurers.
- Form regulation, the ability of the regulator to control what will and will not be included in an insurance policy, would be reduced substantially compared to most states.
- Fees covering the cost of the system would be assessed on those operating under the federal system.
- National insurers would continue to pay state premium taxes, so there should be no loss of premium tax revenue to the states.
- National insurers would continue to be subject to state laws requiring participation in residual market entities, but only if rates charged by the residual market entity covers all costs incurred, and only if there are no rate and form requirements concurrent with participation.
- Reform of the state regulation of surplus lines insurance—only the state in which the insured resides or does business would be allowed to tax surplus lines insurance.

<sup>10</sup> See [http://www.house.gov/apps/list/hearing/financialsvcs\\_dem/oskanjorski100307.pdf](http://www.house.gov/apps/list/hearing/financialsvcs_dem/oskanjorski100307.pdf), visited on December 13, 2007.

<sup>11</sup> A complete summary can be found in **Appendix**.

<sup>12</sup> Surplus lines insurance is insurance sold by insurers who are not admitted in particular state. See CRS Report RS22506, *Surplus Lines Insurance: Background and Current Legislation*, by Baird Webel, for more information on this insurance.

- National insurance producers would be allowed to sell surplus lines insurance.
- Would apply federal antitrust laws to national insurers, except to the extent that state laws continue to apply to them.

Differences between S. 40 and H.R. 3200 are relatively minor, including the following:

- H.R. 3200 would specifically allow non-U.S. reinsurers to file financial data in accordance with International Financial Reporting Standards.
- H.R. 3200 would limit jurisdiction over non-U.S. reinsurers to federal courts, rather than including state and local courts.
- H.R. 3200 would broaden slightly and clarify anti-fraud language.

Beyond the general aspects inherent in the OFC concept, such as the dual, competing regulatory structures and uniform regulation across the country, the most striking specific aspect of S. 40 and H.R. 3200 is the lessening of the rate and form regulation under these bills as compared to the current system. Currently every state has some measure of rate and form regulation.<sup>13</sup> In some states, insurers must get specific prior approval for changes to rates and forms, while in others insurers may have some freedom to change rates and forms with the possibility that the state insurance commissioner could disallow the change after the fact. S. 40 and H.R. 3200 specifically disallow rate and form regulation for national property/casualty insurers. Such insurers are only required to maintain copies of the policy forms that they use. National life insurers are subject to general standards and must file forms with the commissioner before these forms are to be used.

## 109<sup>th</sup> Congress

### The National Insurance Act of 2006

Senators John Sununu and Tim Johnson introduced S. 2509 on April 5, 2006. The House companion, H.R. 6225 was introduced on October 18, 2006. Neither bill saw direct committee action, although S. 2509 was repeatedly discussed at a hearing on “Perspectives in Insurance Regulation,” held by the Senate Banking, Housing, and Urban Affairs Committee on July 18, 2006. These bills were very similar to the bills of the same name introduced in the 110<sup>th</sup> Congress and discussed above. Differences between the bills in the two Congresses included the following:

- The 2006 bills did not address surplus lines insurance.
- The 2007 bills added language requiring national insurer compliance with anti-money laundering laws.
- The 2007 bills specifically exclude national insurers from offering title insurance.
- The 2007 bills included new guaranty fund language, changing the focus from a qualified state, to a qualified association or fund. If a state’s guaranty fund is not qualified, then the national insurers operating in that state must join the national guaranty fund to be established by the National Insurance Commissioner.

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<sup>13</sup> A chart of various state regulations can be found at the website of the Insurance Information Institute, a property/casualty insurer organization. [http://www.iii.org/media/hottopics/insurance/ratereg/?table\\_sort\\_575580=3](http://www.iii.org/media/hottopics/insurance/ratereg/?table_sort_575580=3), visited on Dec. 10, 2007.

## 107<sup>th</sup> Congress

### The Insurance Industry Modernization and Consumer Protection Act

H.R. 3766 was introduced on February 14, 2002, by Representative John LaFalce. It would also have created an optional federal charter for “national insurers,” but not for insurance agencies, brokers, or agents. It would have created a new federal agency within the Treasury Department, known as the Office of National Insurers and headed by a director, rather than a commissioner. Other significant aspects of H.R. 3766 included the following:

- The federal charter could provide for a national insurer to underwrite both life insurance and property/casualty insurance.
- The director would have had general regulatory authority over national insurers, including solvency oversight and policy forms, but rate regulation would have been left with state insurance regulators.
- Even though the legislation had no provision for the licensing of insurance producers, the director would have had the authority to enforce unfair and deceptive practices rules against state-licensed producers with respect to the sale of insurance products issued by national insurers, and all states would have been subject to federal minimum standards.
- National insurers would have been encouraged to invest in the communities in which they sell policies.
- National insurers would have been required to file reports containing community sales data for use by federal regulators in combating insurance redlining. Further, national insurers would have been prohibited from refusing to insure, or limiting coverage on a property, based solely on its geographic location.

### The National Insurance Chartering and Supervision Act

This proposal was reportedly introduced late in 2001 by Senator Charles Schumer, but was never assigned a number, nor referred to either the Senate Commerce Committee or the Senate Banking, Housing, and Urban Affairs Committee.<sup>14</sup> A draft of this proposal<sup>15</sup> provided that the chartering, supervision, and regulation of National Insurance Companies and National Insurance Agencies be administered by the federal government in a newly created federal agency within the Treasury Department. The proposed agency, the Office of the National Insurance Commissioner, would have been headed by the National Insurance Commissioner, appointed for a five-year term by the President and subject to Senate confirmation. National insurers and agents would have been exempt from most state insurance law. Significant aspects of the bill included

- application to all lines of insurance, including life, health, and property/casualty;

<sup>14</sup> See, for example, “Chartering Bill Introduced; Industry Divided on Federal Proposal,” *Business Insurance*, Jan. 7, 2002, p. 1 and “Schumer working on Federal Regulation and Terrorism Backstop Bills in the Senate,” *BestWire*, Mar. 13, 2002.

<sup>15</sup> Draft Language can be found under “Testimony” at [http://www.aba.com/ABIA/ABIA\\_Reg\\_Mod\\_Page.htm](http://www.aba.com/ABIA/ABIA_Reg_Mod_Page.htm), visited Dec. 14, 2007.

- imposition of fees as necessary to cover the expenses of the federal apparatus;  
and
- requirement that NICs participate in “qualified” state insurance guaranty associations and establishment of a federal backup guaranty association to cover “non-qualifying” states.

The broad powers granted to the National Insurance Commissioner were not to include the authority to regulate rates or policy forms. Nor would the Schumer proposal have exempted federally chartered NICs from anti-trust laws, except for purposes of preparing policy forms and participating in state residual market programs such as assigned risk pools in automobile insurance. The federal license would have specified the line or lines of insurance a NIC could underwrite, and no single NIC could be licensed to underwrite both life/health insurance and property/casualty insurance, although an affiliated group of insurance companies (state and/or federally chartered) could have included separate companies writing those different lines of insurance.

## Appendix. Summary of S. 40 and H.R. 3200<sup>16</sup>

### Office of National Insurance (Title I)

The Office of National Insurance would be headed by the Commissioner of National Insurance who is to be appointed by the President and confirmed by the Senate for a term of five years. The office is to be within the Department of the Treasury, but the Secretary of the Treasury is limited to general oversight and may not intervene in specific matters before the commissioner. It is to be funded by fees and assessments on the entities that the commissioner is empowered to license and supervise—insurers, insurance agencies, and insurance producers who seek a national license. Within the office, there would also be established a Division of Insurance Fraud, a Division of Consumer Affairs, and an Office of the Ombudsman.

The commissioner may, but is not required to, consult with state insurance regulators and may, but is not required to, engage in international cooperation with regard to insurance regulation in global markets. This international cooperation may include development of mutual recognition agreements. Any international efforts, however, require consultation and cooperation with the Executive Office of the President and the United States Trade Representative. The subtitle grants general rule-making authority to the commissioner, and specifically forbids delegation of this authority to a self-regulatory organization (SRO). SROs that are registered and overseen by the commissioner can, however, enforce compliance by their members with the act and federal regulations under the act.

### Supervision and Law Enforcement

The commissioner would be required to examine on-site each National Insurer not less than once every three years and may do so whenever necessary. A National Agency, in contrast, may be examined only in response to a complaint or any other evidence of a specific violation or impending violation. [*H.R. 3200 removes the “only,” broadening when a National Agency might be examined.*] The examination powers are to be broad, including the possibility of court orders and subpoenas if prompt and reasonable access is not given by the examinee, and extend to the activities of affiliates. The costs of examinations are to be assessed against the national insurers, agencies, and producers with the initial start up period funded by borrowing from the Treasury. The monies from the assessments and other fees are not to be treated as appropriated funds.

State laws with regard to the sale and underwriting of insurance, as well as other insurance operations, would be generally preempted with regard to National Insurers, agencies, and producers. The specific exceptions to this preemption include state unclaimed property laws, premium tax laws, and laws requiring: (1) participation in residual market mechanisms; (2) compulsory coverage of auto or workers compensation insurance; (3) participation in a statistical organization; and (4) participation in a workers compensation administration mechanism.

The enforcement powers of the commissioner are to include the suspension, restriction, or revocation of a federal license of an insurer, agency, or producer. Taking such action would require various due process steps including notice to the accused, hearings, and judicial review.

<sup>16</sup> Differences between S. 40 and H.R. 3200 appear in italics and brackets.

Remedies open to the commissioner would include cease-and-desist orders, license suspension or revocation, civil monetary penalties and criminal charges. The commissioner would in most circumstances publicly disclose enforcement actions and national insurers and agencies must disclose any impending enforcement actions. The commissioner may request assistance from foreign governments in investigations and may also take action against non-U.S. insurers for conduct that occurs within the United States.

The commissioner would be empowered to investigate insurance fraud and reporting of such fraud by any person engaged in the business of insurance would be mandatory. Anyone reporting fraud would be given immunity from prosecution for that act. (A later section, 1713, makes insurance fraud a federal crime.) [*H.R. 3200 clarifies some anti-fraud language, including broadening the immunity for those reporting fraud.*]

## **National Insurance Companies and National Insurance Agencies (Title II)**

### **Organization, Licensing, and Operations**

The organization, incorporation, operation, and regulation of National Insurers and National Agencies would occur under regulations to be prescribed by and charters to be issued by the commissioner. This authority could not be delegated to any self-regulatory organization. The corporate names of National Insurers would be required to end with either those words or the initials “N.I.” while National Agencies’ names would be required to end with “National Insurance Agency” or the initials “N.I.A.”

National Insurers would be allowed to organize as stock, mutual, reciprocal, or fraternal companies, while National Agencies would be required to be organized as stock companies. In order to grant a charter, the commissioner would be required to consider the character and competence of the applicants as well as their financial resources. If an application is denied, the commissioner would be required to issue a written explanation of the denial. A licensed National Insurer could offer life insurance or property/casualty insurance but not both. A license for a particular line also would entitle the National Insurer to offer reinsurance for that line. The commissioner would be forbidden from imposing additional conditions on non-U.S. insurers unless these conditions were necessary for the protection of policyholders and justified in a written finding. A National Agency would be expressly permitted to sell surplus lines insurance.

National Insurers and Agencies’ corporate governance rules would be required to be consistent with the act and any state laws, except where the commissioner determines that a state law is discriminatory towards National Insurers or Agencies. In this case, the state law would be preempted. National Insurers and Agencies would be required to establish an independent audit committee.

National Insurers and Agencies would be permitted, under rules to be prescribed by the commissioner to convert to state insurers or agencies, and vice versa. A state insurer converting to a national insurer would also be permitted to change its corporate form, e.g. a state mutual insurer converting to a stock National Insurer.

A National Insurer would be permitted to establish subsidiaries but must obtain written approval from the commissioner to invest more than 20% of its assets in a single subsidiary or 40% of its

assets in two or more subsidiaries. This approval would not be necessary if the subsidiaries are engaged in insurance activity which the National Insurer is authorized to undertake. A National Life Insurer may establish separate accounts and a National Insurer may establish protected cells. These separate accounts and protected cells are to be isolated from the rest of the insurer's assets and income. (Separate accounts are often used in conjunction with annuities, while protected cells are often used in conjunction with catastrophe bonds or other securitizations.)

## **Financial, Product, and Market Regulation**

The commissioner would be required to establish initial financial regulations consistent with various National Association of Insurance Commissioners (NAIC) models as the models existed at the introduction of the bill. These regulations are to be adopted within two years and would be in effect for at least five years. After this five-year period, the commissioner could, but is not required to, modify the regulations. The commissioner would also be authorized to promulgate other regulations on these topics as is determined necessary.

National Life Insurers would be allowed to underwrite risks and set rates according to sound actuarial principles or experience. The commissioner would be authorized to set standards for life policies and life insurers would be required to file their policy forms with the commissioner before using these forms, unless the commissioner exempts particular categories from the filing requirement. There is no requirement for form approval. The commissioner would be given specific authority to define "insurable interest."

Property/casualty National Insurers would be required to maintain copies of all policy forms and provide a list of these forms to the commissioner every year. The commissioner would specifically not be authorized to require the use of any particular form or rate for property/casualty insurance.

For all National Insurers, Agencies, and producers, the commissioner would be required to promulgate regulations preventing unfair competition, and unfair and deceptive acts in the marketing and sales of insurance policies and products.

## **Reinsurance**

The commissioner would be authorized to issue a license for reinsurance to an insurer who is not a National Insurer in order to promote the public interest in sufficient reinsurance capacity and the need for competition. Such licenses could not be issued until after the commissioner has fulfilled all requirements to charter and to issue licenses to National Insurers. In order for a non-U.S. reinsurer to obtain a license, it would be required to report its financials in a similar form as National Insurers [*H.R. 3200 specifically allows statements in conformance with International Financial Reporting Standards*], to submit to all U.S. jurisdictions [*H.R. 3200 limits this to federal courts*], and to demonstrate that all U.S. court judgments would be enforceable [*H.R. 3200 has slightly broader standards for this*]. All reinsurers would be required to submit annual reports of their financial condition. Any national insurer may take credit for reinsurance purchased from a federally licensed reinsurer and any state insurer may take similar credit notwithstanding any state law or regulation to the contrary.

## **Acquisitions of Control; Mergers; Bulk Transfers; Domestication**

No person would be allowed to obtain a controlling interest in a National Insurer or Agency without approval by the commissioner. Such approval would be automatic unless the commissioner specifically finds the transfer of control would: (1) cause the insurer or agency to be unable to satisfy the requirements for a federal insurance license; (2) jeopardize the financial stability of the insurer or agency; (3) be unfair and unreasonable to the policyholders; (4) place the control of the insurer or agency in the hands of those lacking competence, experience or integrity; or (5) be hazardous to the insurance-buying public. Mergers of National Insurers would be permitted, but would also require the approval of the commissioner, who would be directed to establish regulations and procedures for these mergers. Mergers of National Agencies would also be permitted subject to rules that the commissioner may establish. A merged National Agency would be required to give up any state licenses that the predecessor agencies might have held and obtain national licenses for any lines of insurance that it did not already hold.

Bulk transfers, the transfer of existing insurance policies that constitute all or substantially all of one insurer's business in a particular line or under a particular policy form, would be expressly permitted with prior approval of the commissioner. Approval by policyholders would not be required and state laws requiring policyholder approval would be preempted. A state would not be permitted to treat bulk transfers by national insurers differently than by state insurers.

A non-U.S. insurer with a branch in the United States would be permitted to domesticate its U.S. branch if approved by the commissioner.

## **Conversion of Corporate Form**

In general, both life and property/casualty companies would be permitted to convert from a mutual insurer to a stock insurer, but only life insurers would be permitted to convert from a stock insurer to a mutual insurer. Conversions would be subject to the act's requirements and regulations as promulgated by the commissioner. The commissioner would have approval authority over conversions, but must approve conversions if the conversion is fair and equitable to policyholders, does not violate the law, and results in a company that would satisfy the requirements for national licensure. In addition, conversions would require approval by a policyholder vote. After a stock to mutual conversion, all membership rights to the insurer's surplus would be extinguished. In the five years following a mutual to stock conversion, the Commissioner's approval would be required for any person to acquire more than 5% of the company's stock. The states would be specifically prevented from interfering with a conversion into a National Insurer.

## **State Taxation**

National Agencies and Insurers would be subject to the same state and local taxation as state agencies and insurers. A National Insurer would be able to choose a specific state of domicile for the purposes of taxation. National Agencies would be considered to be domiciled in the state in which their principal place of business is located. States are specifically prohibited from imposing any additional taxes on National Agencies or Insurers. Surplus lines insurance may be taxed only by the state in which the insured maintains its principal place of business or residence.

## **Insurance Producers and Other Insurance Servicing Persons (Title III)**

The commissioner would have the authority to issue federal licenses to insurance producers; such a license would be automatically issued to a National Agency and could also be sought by independent insurance producers. The lines of insurance covered by the federal license would be defined by regulation, and would include surplus lines insurance. A federal licensee would be authorized to sell, solicit, or negotiate insurance in any state for any line that is specified in the license. The commissioner may examine federal licensees only in response to a complaint or other evidence of wrongdoing, but would have the authority to prescribe the filing of reports. An electronic database of federal producers is to be developed by the commissioner and to be linked to state insurance regulators and insurers. National Insurers and Agencies would have a duty to supervise the sales and marketing practices of federal producers who are their employees or agents. States are generally preempted from interfering with the actions of federally licensed producers, including when those producers are acting on behalf of a state insurer. The commissioner is to put in place federal regulations for producer licensing within two years and no licenses may be issued before these are in place.

## **Holding Companies (Title IV)**

All National Insurers and Agencies who are members of a holding company would be required to register as such with the commissioner. Transactions within the insurance holding company would be required to be fair, reasonable, and at least as favorable to the National Insurer or National Agency as those that would be offered to, or would apply to, a nonaffiliate. The commissioner may specify certain transactions that would require prior notice and approval. These requirements would not apply if the commissioner exempts a National Insurer or Agency from them either in whole or in part. An agency or insurer may also file a disclaimer of affiliation to be relieved of the requirements. The commissioner would be required to allow this disclaimer unless specifically disallowed after an open hearing. Any extraordinary dividends (defined as the greater of 10% of the policyholder surplus or the insurer's net income for the previous 12 months) to be paid by member of an insurance holding company would be subject to the commissioner's approval. If the commissioner does not specifically disapprove such dividends within 30 days, they would be deemed to be approved.

## **Receivership and Insolvency Protection (Titles V-VI)**

The commissioner would be authorized to establish a receivership for a National Insurer, providing for either liquidation or rehabilitation, on a number of grounds including insolvency, violation of cease and desist orders or other laws, and money laundering. Receivership proceedings would follow regulations and standards to be issued by the commissioner and based on the Uniform Receivership Law adopted by the Interstate Insurance Receivership Compact Commission in September 1998. A National Insurer who is the subject of a receivership appointment may bring an action in U.S. District Court to review this appointment.

All National Insurers would be required to join the state guaranty association, either for life/health or property/casualty insurance, providing the association is "qualified." The commissioner would determine whether a state association was "qualified" based on it admitting on a non-discriminatory basis both state and National Insurers, and it providing benefits for

policyholders in the event an insurer is placed into receivership. The benefits must be equivalent to those offered by the National Insurance Guaranty Corporation (NIGC) as contained in the bill.

Should any state's primary guaranty association be determined not to be qualified, the NIGC would be created. Both national and state insurers would be required to join this corporation if they do business in a state with a non-qualified association. The NIGC would be a non-profit corporation subject to the oversight of the commissioner but would not be an agency of the federal government and would not be backed by the full faith and credit of the United States. Its regulations for lines of insurance covered and the scope of the coverage would be issued by the commissioner and would be based on the NAIC's Life and Health Insurance Guaranty Association Model Act and Property/Casualty Guaranty Association Model Act currently in place. The commissioner would have the authority to change federal regulations as the NAIC models change, but would not be required to do so.

The NIGC would establish six separate accounts for different lines of insurance. Its funding would come from assessments on member insurers, with life/health insurers responsible for the life, annuity, and health accounts and property/casualty insurers responsible for the workers compensation, automobile, and "all other lines" accounts. Outside of the assessments for administrative and general expenses, an insurer's payments would be based on its size and on the NIGC's obligations from failed insurers. The NIGC would not build up money to pre-fund future liabilities. States would be required to provide NIGC assessments with the same deductions or offsets against state taxes that they do for state guaranty fund assessments or they would be stripped of the authority to tax National Insurers.

## **Federal Antitrust Exemption (Title VII)**

National Insurers, Agencies and federally licensed producers would now be subject to federal antitrust laws except with regard to the development and use of standard insurance policy forms. The McCarran-Ferguson Act's exemption to federal antitrust laws would still apply to the extent that national insurers, agencies, and producers are subject to state law.

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