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## **Optional Federal Charter for Insurers: FAQ**

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This paper provides a free market perspective on the idea of optional federal insurance chartering. Two very similar National Insurance Act bills now before the House (H.R. 3200) and Senate (S. 40) would create a new national insurance regulator, setting up a system known as an Optional Federal Charter (OFC). (This paper does not endorse or oppose any specific bill.)

An OFC would let insurers organize themselves under either federal or state law. Currently, insurers operating in a given state must operate under that state's insurance laws. A federally chartered insurance company would have to obey all general state business regulations, but would work under a new federal bureau, which would enforce the same insurance-specific laws throughout the country. Federally chartered insurance companies would sell homeowners', life, and auto insurance, but not health insurance.

The proposals before Congress would set up new national mechanisms to protect consumers against insurance fraud and to ensure federally chartered insurers' solvency. These systems would work similarly to existing state-level bodies. The proposed House and Senate bills contain no mechanisms to let government set rates. However, 49 do have such laws and much of the controversy over these bills stems from the fact that OFC would eliminate these price controls.

### **Would optional federal chartering create a big new federal bureaucracy?**

*No*, at least not under the bills proposed. The new federal regulatory apparatus would probably employ fewer people than the insurance commissioner's office of a medium-sized state. About half of state insurance bureaucrats work to review insurance company rate filings; the proposed federal agency would not do that. Former and current state insurance commissioners estimate that a new federal regulator would need to employ

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between 200 and 350 people to function—fewer employees than in the Department of Health and Human Services’ Inspector General’s office, at 378.

**Would it increase compliance costs?** *No.* Compliance costs would likely decrease under an OFC. Right now, an insurance business seeking to operate across the country needs separate regulatory approval from 50 states and the District of Columbia. Under an OFC, it would only need one approval. Compliance costs for multi-state companies—which sell most insurance—would go down, while compliance costs for single-state companies would stay the same. Of course, any expansion of government deserves a good deal of skepticism: Bureaucracies can become much bigger than their proponents initially promise, which is something that Members of Congress should guard against.

**What is really wrong with the current state system?** *It stifles innovation.* Quite simply, there is no current “system” to criticize but, rather, 50 separate state systems plus a separate system for the District of Columbia. Some states *do* have insurance regulation systems that seem to do a decent job at serving customers and insurers alike. But others do not. One major problem stands out: The current system has brought insurance innovation to a standstill. Since insurers introduced modern homeowners’ insurance in 1959, the industry has not introduced a single entirely new property and casualty insurance product for individual customers.

**Will an OFC help to produce new products?** *Probably.* Wholly new insurance products have not come out because any new product needs at least 51 sets of different regulatory approvals. Insurance works best when large numbers of people pool their risks together; it is very hard to make money—or simply break even—by launching a product in only one or two states (some insurers must get more than one approval in one state and also operate in U.S. territories).

**Will states lose tax revenue under an Optional Federal Charter?** *Not under the current proposals.* Over 99 percent of taxes from insurance companies are in the form of taxes assessed on all businesses and policy-specific premium taxes—which federally chartered companies would still have to pay to the states in which they operate. States would not charge licensing fees to agents who opt to take federal exams instead of state ones, but they would not be required to license those agents, either.

**Would an OFC subject insurance companies to both federal and state laws, thus increasing the overall burden of regulation?** *This is a legitimate concern, but the bills currently before Congress would draw a bright line between federal and state regulation.* However, attempts to erase this line and eliminate the optional nature of the proposed legislation would increase the overall regulatory burden and reduce the market’s role in insurance provision. Congress should approach any proposal that subjects state-regulated companies to federal oversight with extreme skepticism. An OFC will accomplish its goals best if the line between federal and state control remains clear.

**What would an OFC do to state regulation? What about federalism?** *The current proposals do not touch state regulation.* Unless states change their laws, nothing

will change for insurance companies that continue to subject themselves to state regulation or for their customers. In the longer term, some states may modify their laws in response to an OFC law better to tailor regulations to each state's situation.

**Would there be a “race to the bottom”?** *No.* The history of regulatory competition shows almost no evidence of a “race to the bottom” ever occurring. When only one regulator exists, consumers and businesses must stick with whatever regulatory system their home state imposes. The existence of more than one regulator lets consumers and businesses work together to figure out more optimal levels of regulation.

**Would local insurance agents go out of business under an OFC?** *Insurance agents would certainly face new business challenges under an OFC regime. Some would use these as opportunities to grow their businesses, while others would likely run into problems.* Insurance agents ambitious to grow their businesses while maintaining lifetime customer relationships would find new opportunities under an OFC. Rather than having to secure new licensing in every state in which they want to operate, agents could simply seek a federal license and follow their customers anywhere in the country. Good insurance agents are trusted financial advisors and they should be able to serve their customers even after their customers move across state lines. More flexible licensing could also give agents new products to sell.

Some OFC opponents point out that only a small percentage of agents—about one in five—currently work in more than one state. This is true but misleading. The current regulatory environment makes it very difficult for agents to work across state lines. Each additional state in which an agent wishes to work requires a new licensing exam, fees, and background checks. Under an OFC more agents would be able to follow their customers and maintain businesses in more than one state. While it is true that insurance agents who want to keep all of their customers in a small, confined geographic area would likely have a harder time competing under an OFC, many agents who do not currently work across state lines would begin to do so under an OFC.

**Would insurance companies withdraw from certain parts of the country under an OFC?** *No.* To the contrary, more companies likely would come into currently underserved regions. States like Florida and Massachusetts have chased away insurers through overregulation. Even states with less burdensome regulations have trouble attracting business simply because additional regulatory hurdles discourage companies from entering some states. A single national regulator would make market entry easier and increase consumer choice.

**Would an OFC protect consumers from rapacious insurance companies?** *Yes.* The proposed OFC law before Congress would create a consumer ombudsman and the first ever federal programs designed to protect consumers from insurance fraud. By that standard, it would enhance consumer protection. However, many measures listed as “consumer protection” in fact limit consumer choice or ration products. If one believes that the government should control which products a consumer buys or set prices for those products, then, an OFC does not “protect” consumers the way some state laws do.

**Will it confuse consumers? *Confusion already exists.*** Former District of Columbia insurance commissioner Lawrence Mirel says that his office frequently got calls from people looking for the—non-existent—federal agency that oversees insurance. An OFC would create such an agency.

**Don't government-set rates protect consumers? *No, they hurt consumers and encourage foolhardy risk taking.*** Illinois and California have two of America's biggest insurance markets, and they have very different regulatory systems. Illinois lets the market set insurance rates. California has the government approve every rate that insurers want to charge before they can charge it. In general, rates for homeowners and auto insurance in both states move up or down at the same time. However, after adjusting for a variety of factors Illinois consumers generally pay less for insurance and have faced fewer price shocks from rapidly rising rates.

In any case, why should government set rates at all? Each time government demands a profit-making insurance company to lower its rates for one group or ignore a risk factor, it will necessarily cause that company to raise rates for another group. Thus, insurance rate setting by states redistributes wealth from the risk-averse to the risk-prone. When government mandates low insurance rates for people who drive fast sports cars or build mansions on sand dunes, it inevitably raises rates for careful minivan drivers and inland residents. If government really wants to help people of modest means afford insurance, it would do better to subsidize those people directly. (However, such subsidies themselves raise a host of questions that go beyond the scope of this paper.)

**Is an OFC the only way America could liberalize its insurance markets? *Definitely not.*** An optional federal charter is only a small first step towards a truly free market for insurance. Free market advocates should approach any new federal regulator with a healthy dose of skepticism. The Competitive Enterprise Institute generally approves of an OFC in concept (although not the particular bills before Congress) not out of love for a new federal regulator, but because an OFC would create competition between regulators. A wealth of academic literature shows that competitive regulation produces better regulation for everyone. For example, since the United States liberalized banking laws in the 1990s, customers have gotten higher interest rates on deposits, paid less for loans, and seen banks add weekend hours.

The creation of an Optional Federal Charter is the best option with serious support right now. Congress should also investigate measures to authorize private entities to regulate insurance companies, let insurance companies sell policies across state lines under the laws of their home state, and let the market create entirely new types of risk-transfer products. All of these options offer some of the benefits of an OFC and, upon analysis, some may well emerge as better than an OFC.