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Statement of the Shadow Financial Regulatory Committee

on

Optional Federal Chartering of Insurance Companies

May 7, 2001

The enactment of financial services modernization legislation has increased debate on the efficacy of the traditional system of state insurance regulation. That debate has focused heavily on the direct and indirect costs of state regulation of insurance prices, contract language, and producer licensing. Costs and delays incurred by multi-state insurance companies and agents that must deal with multiple and often conflicting state rules and procedures, including elaborate systems of price controls in some states, have assumed greater importance in an environment of financial modernization, growing electronic commerce, and global competition.

Many states and the National Association of Insurance Commissioners have taken several steps to address these problems. Traditional industry support for state regulation has nonetheless eroded, and many observers view federal regulation as offering the potential for reductions in the direct and indirect costs of regulation through less intrusive and more uniform regulation.

The ABA Insurance Association released a proposal for a system of optional federal chartering of insurers last year. In April, the American Council of Life Insurers released its own draft proposal for optional federal chartering of life insurers. The American Insurance Association is considering whether to propose such a system. The House Committee on Financial Services could hold hearings on possible federal chartering of insurers before year-end.

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The Shadow Committee believes that there are several potential efficiencies from adopting some form of optional federal chartering system for insurance companies. Specifically, a properly designed system of optional federal chartering should:

- Enhance competition by streamlining, centralizing, or eliminating antiquated regulations of multi-state insurers and insurance producers
- Provide federally chartered insurers with a broad exemption from state regulation of rates and contract forms
- Enhance market discipline by, for example, removing existing state guarantees of the obligations of insurers for policies sold to large businesses
- Promote beneficial regulatory competition between federal and state regulators to the maximum extent possible
- Avoid excessively burdensome consumer protections and eschew mandates that would ultimately require policyholders to subsidize particular sectors or groups

There are, however, substantial risks associated with optional federal chartering. For example, the temptation to use insurance regulation to redistribute wealth will not necessarily be lower at the federal level or in a dual regulatory system. More important from the perspective of the health of the overall financial system, optional federal chartering in practice might be accompanied by expanded protection of insurance buyers against loss from insurer insolvency. Such expansion could materially undermine market discipline and therefore increase moral hazard. The Committee therefore strongly recommends that the Congress only give serious consideration to proposals that are designed to achieve the potential efficiencies outlined above while limiting the associated risks.