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The National Insurance Act of 2007

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Insurance: The Proposed National Insurance Act of 2007

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ARTICLE: A bill that would revolutionize insurance law and the insurance industry is pending before Congress. It would allow insurance companies to choose to be federally chartered or licensed by the federal government rather than by individual states. They then would deal with one group of regulators and one set of regulations rather than those of the several states. This commentary surveys the numerous provisions of this potentially landmark legislation and presents the views of those in favor and those opposed to it.

For the complete commentary, click on the above link.

Introduction

Insurance companies have historically used the same information and statistics to set rates for various types of policies. In 1944, the U.S. Supreme Court, in [United States v. South-Eastern Underwriters Ass'n, 322 U.S. 533 \(U.S. 1944\)](#) held that rate setting involved interstate commerce and the use of standard rates and forms could violate the Sherman Antitrust Act. In response, Congress enacted the McCarran-Ferguson Act, which provided limited antitrust exemptions to insurance companies in using standard forms, setting rates, and exchanging risk information. "The calls for the repeal of McCarran, perhaps coupled with federal regulation of the insurance industry in place of the current state regulatory scheme, are gaining in intensity and momentum." Ruth T. Dowling, Patricia A. Sullivan and Marc S. Voses, *Antitrust Enforcement In The International Insurance Industry: How The EC's Examination Of The Block Exemption May (And Should) Inform The U.S. Debate Over The Future Of McCarran Ferguson*, 2-6 LexisNexis Antitrust Rep. NewsBrief 21 (2007). One response is the introduction by Senators John Sununu and Tim Johnson of [2007 S. 40](#), the National Insurance Act of 2007 in the Senate and by Rep. Melissa Bean (D-IL) and Rep. Ed Royce (R-CA), in the House.

The National Insurance Act is a proposal to allow insurance companies to be chartered by the federal government rather than by individual states. It also permits insurance brokers and agents to be federally licensed. In discussing the bill, Senator Johnson stated:

Since Gramm-Leach-Bliley, Congress has modernized the regulatory schemes for every part of the financial services industry except insurance. We have a responsibility to promote a balanced regulatory system that will allow the insurance

industry to meet the highest standards of performance, innovation and progress; I believe the National Insurance Act of 2007 will achieve this.

Press Release, Senator John Sununu, SUNUNU, JOHNSON: MARKETPLACE DEMANDS INSURANCE REGULATORY REFORM, *Senators re-introduce "National Insurance Act" to respond to the needs of America's insurers and consumers*, May 24, 2007.

This commentary will examine some of the more important provisions in the proposal and some of the issues raised by it.

Reason for the Bill

At the current time, insurance is regulated state by state. Each state charters each individual insurance company permitted to underwrite insurance in its state. Each state regulates methods of insurance company bookkeeping, how premiums are to be invested, and minimum reserves to pay claims. States are actively involved in approving policy forms and rates, what must be included in different types of insurance policies, and payment of claims. There are insurance companies that underwrite insurance in every state and find it onerous to deal and comply with different regulations, particularly where they are writing insurance for entities that also have facilities nationwide.

In a press release when introducing the bill, Rep. Bean stated:

Regulatory obstacles currently discourage insurance innovation and nimble product development to capitalize on emerging growth markets. Eliminating the need to coordinate with 51 state regulators and accelerating the time to market potential will foster greater industry innovation and agility.

BEAN/ROYCE: BI-PARTISAN DEMAND FOR INSURANCE REGULATORY REFORM, *First bipartisan House version of National Insurance Act would offer insurance consumers and providers with much-needed regulatory alternative*. July 25, 2007.

Those supporting the bill believe it is market driven by the need for uniformity to enable insurers to work with one set of regulations and one group of regulators while writing insurance for companies located across the nation.

Provisions of the Bill

Optional nature

Under the proposal, no insurance company or producer would be required to be federally chartered or licensed. The regulations would parallel those established by the states, in the same manner that federal banks are chartered by the federal government, while still permitting states to charter banks and savings and loan associations. States would retain responsibility to charter and license insurers and producers and to regulate their activities.

Large nationwide insurance companies and producers might like the fact that they are dealing with one group of regulators and one set of regulations, when writing

insurance for facilities in every state. Large companies, such as retail chains, multi-state manufacturers, delivery services, restaurant chains, real estate holding companies, or utilities may find it less costly and cumbersome to purchase insurance and to determine what is best for them.

On the other hand, states would be reluctant to give up their power to mandate minimum standards or to oversee insurers and producers to make sure that they perform or risk losing their ability to do business in the state. The National Association of Mutual Insurance Companies (NAMIC), through their president, John Bykowski, in testimony before the Committee on House Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, INSURANCE REGULATION CQ Congressional Testimony, Oct. 3, 2007, stated:

Notwithstanding the need to improve state-based regulation, NAMIC believes the decentralized system of state-based insurance regulation has inherent virtues that would be lacking in a national insurance regulatory system. State insurance regulation has the capacity to adapt to local market conditions, to the benefit of consumers and companies, and affords states the opportunity to experiment and learn from each other.

Office of National Insurance

The proposal would create a new Office of National Insurance to promulgate regulations and oversee federally chartered and licensed insurance companies and producers. The ONI would be an independent agency located in the Department of the Treasury, with a Commissioner appointed to a five-year term by the President with the advice and consent of the Senate. The Commissioner is given six months to issue initial regulations concerning federally chartered and licensed insurance companies and producers. The powers of the Commissioner are to extend not just over federally chartered insurer and licensed producers, but also to any registered insurance self-regulatory organization. If enacted, the Commissioner would have up to two years in which to issue regulations governing the registration and operations of insurance self-regulatory organizations.

Chartering of Two Types of Insurance Companies

Title II of the proposed act covers the organization, incorporation, operation, and regulation of national insurance companies and national insurance agencies. Both life insurance companies and property/casualty insurance companies could choose to become federally chartered. While a holding company may own both, each would be separately regulated. Non-United States insurance companies may transact insurance in the United States through a United States branch by qualifying and licensing the branch to do business as a national insurer under the Act.

A life insurance company, at the time of its chartering as a National Insurance Company, may elect to adhere to participating policy procedures of the relevant law of the State in which its main office is located; or adhere to the participating policy procedures established by regulation of the Commissioner.

Property/casualty insurers will be subject to federal regulations and states are preempted from taking any action that would establish an asset or reduce its liability as a result of insurance ceded to a national insurer or a federally licensed reinsurer.

Licensing of Agencies and Producers

Title III of the proposed Act covers the licensing of insurance agencies and producers. A federally licensed agency or producer could sell insurance from a nationally chartered insurer in every state. A state licensed producer could sell insurance on behalf of any insurer, including National Insurers, operating within the state in which the producer holds a license.

Conversion Between State and Federal Charters

The bill provides for conversion of a state chartered insurer to one federally chartered and the right to convert back to state charter.

Applicable State Law

While federal law will control the operations of federally chartered insurers, state law will still apply in respect to state tax laws, liability of directors and officers, residual market mechanisms designed to make insurance available to those unable to obtain insurance, compulsory coverage of workers' compensation or motor vehicle insurance, and contract law.

Regulatory Powers

The Commissioner is required to issue financial regulations which are consistent with the statutory accounting practices promulgated by the National Association of Insurance Commissioners (NAIC) in its "Accounting Practices and Procedures Manual". Auditing, investing, risk-based management, and other accounting practices should also follow model acts promulgated by the NAIC.

In respect to life insurance, the Commissioner is required to establish regulations consistent with the provisions of the Act. In respect to property and casualty insurance, the Act does not authorize the Commissioner to require a national insurer to use any particular rate, rating element, price, or form.

The Commissioner is required to issue regulations establishing standards for licensing agencies and producers, including such items as education, lines of insurance, and examination of producers. The Commissioner is also required to promulgate regulations concerning sales and marketing of insurers and producers to prevent unfair trade practices and fraud.

Enforcement Power

The Commissioner has the authority to conduct an investigation and to suspend or revoke a charter or license. In addition, those who violate a law, rule, or regulation may be fined up to a maximum of \$1 million.

Consumer Protection

The Senators and Representatives who introduced the bill have stated that the bill

provides for a Division of Consumer Protection within the Office of National Insurance. Section 1105 of the bill calls for the creation of a Division of Consumer Affairs, with the duty to "support the Commissioner in the implementation and enforcement of the market conduct Regulations." The Commissioner is to issue regulations which address the advertising, sale, and administration of the insurance policies issued by national insurers, as well as claims under such policies and products. Those who are opposed to the bill contend that national insurers would not be subject to state imposed consumer protections, such as time limits in which claims must be paid.

Self-Regulatory Organizations

Self-regulatory organizations may also elect to be federally chartered. For such organizations, the Commissioner may review, approve, abrogate, modify, or add to the operating rules of an insurance self-regulatory organization. The Commissioner may also remove, suspend, or bar an individual from serving as an officer or director of an insurance self-regulatory organization, and may spend or revoke the registration of an insurance self-regulatory organization.

Other Powers of the Commissioner

The Commissioner has the authority to license reinsurers and non-United States insurers. Before any acquisition or merger with a nationally chartered insurer may take place, the Commissioner must approve of such transaction.

In the event a nationally chartered insurer cannot meet its financial obligations, the Commissioner must be named receiver and has the power to resolve or liquidate the financial matters of a national insurer. Regulations governing receiverships are to be based upon the Uniform Receivership Law adopted by the Interstate Insurance Receivership Compact Commission in September 1998.

State Guarantee Funds

State guarantee associations provide coverage to insureds when a state chartered insurer goes into receivership. Where state guarantee associations meet the levels of protection established by the NAIC, national insurers are required to participate in state associations in each state in which they offer insurance. To the extent a state does not provide the level of protection equivalent to NAIC model standards, a national insurer must join the National Insurance Guaranty Corporation, under the National Insurance Act, which will provide such protections to policyholders.

Antitrust Implications

Except in respect to standard insurance policy forms and § 3 of the McCarran-Ferguson Act, [15 USCS § 1013](#), the Sherman Act ([15 USCS § 1](#) et seq.), the Clayton Act ([15 USCS § 12](#) et seq.), the Federal Trade Commission Act ([15 USCS § 41](#) et seq.), and the Robinson-Patman Antidiscrimination Act (74 P.L. 692), will be applicable to national insurers, national agencies, and federally licensed insurance producers to the same extent as other businesses are subject to such laws.

Responses to the Bill

Former Maine Insurance Superintendent Alessandro Iuppa, the National Association

of Insurance Commissioners' most recent former president, testified before a House panel. He claimed that the U.S. market "demands far more dramatic action than the states alone are able to provide. . . . The need to operate within the state patchwork of regulation in the U.S. hinders insurers with risk issues confronting clients who operate on national and international bases." *Former NAIC Chief Touts Federal Regulator*, BestWire, Oct. 30, 2007.

Others supporting the bill include John Castellani, president of Business Roundtable, who sees the need for innovation and regulatory modernization in light of the global economy. *Business Roundtable Joins Federal Charter Campaign*, BestWire, Dec. 07, 2007. Treasury Secretary Henry M. Paulson Jr. sees the initiative as one to improve the global competitiveness of U.S. capital markets. The American Insurance Association supports the proposal creating a dual system, similar to that in banking.

Insurance industry groups are not uniformly in favor of the proposal. The National Association of Mutual Insurance Cos. (NAMIC), the Independent Insurance Agents & Brokers of America and the National Association of Professional Insurance Agents all oppose the measure.

NAMIC is urging Congress to strongly consider the issue before uprooting a system that has been in existence more than 150 years and has the support of property and casualty companies, and insurers alike. NAMIC contends the federal charter would create a cumbersome and over-regulated system, to the detriment of both policyholders and insurance companies. *NAMIC: Optional Federal Charter Would Hurt Consumers and Insurers*, NAMIC Online, (May 24, 2007).

Indiana Insurance Commissioner Jim Atterholt favors an interstate compact over the federal charter, even though federal oversight would not usurp the state's regulatory system. *Parties Choose Sides over Federal Insurance Oversight; Indiana Commissioner, Indianapolis-based National Association of Mutual Insurance Companies Favor Compact*, Indianapolis Business Journal, Aug. 20, 2007

While the bills apparently have bipartisan support and were introduced by bipartisan sponsors, there are political considerations. There is bound to be opposition to the bill because it creates a new bureaucracy. "John Bykowski, chief executive officer of Secura Insurance, said while the rate deregulation the NIA proposes has been long-sought by the industry, many fear the federal bureaucracy it creates could one day morph into something more onerous than what currently exists at the state level." *Subcommittee Chairman Maps Long and Winding Road to Regulatory Reform*, Best's Insurance News, Oct. 4, 2007.

Conclusion

Passage of the National Insurance Act will not be fast or easy.

Hearings on solvency protection. Hearings on enforcement systems. Hearings on product approvals. Hearings on best practices. Hearings on property/casualty and life, on agents and companies, on systems of federal charter, federal standards and regulatory federalism. Hearings, hearings, hearings, break-out sessions, hearings, bipartisan task forces. Oh, and some more hearings.

Such was the legislative plan laid out by Rep. Paul Kanjorski, chairman of the House Financial Services Subcommittee on Capital Markets and Insurance, as he convened the first in what is expected to be a lengthy series of inquiries into ways to reform the U.S. insurance regulatory system.

Subcommittee Chairman Maps Long and Winding Road to Regulatory Reform, Best's Insurance News, Oct. 4, 2007. Although this was the second time this proposal has been introduced, (it was introduced in 2006 by Senator Sununu) its complexity will require careful consideration.

While large insurance companies and nationwide entities may welcome the uniformity presented by a nationally chartered insurer, state officials, and smaller insurers believe that it is far better for insureds that policies focus on the needs of the local community.

"Current inefficiencies in the insurance marketplace are driven by excessive rate and form regulation, which hamper competitive pricing, inhibit product and service innovation, and delay product delivery. Consistency, while desirable and cost effective, will not in and of itself lessen the marketplace inefficiencies resulting from regulatory models that do not uphold competitive economic principles," NAMIC President and Chief Executive Officer Charles M. Chamness said in a statement.

Treasury Review Sparks Comments on Federal Charter, Best's Insurance News, Nov. 26, 2007. The National Governors Association and the Independent Insurance Agents and Brokers of America have both opposed the creation of a dual regulatory system. *Insurance Groups Seek Governor Backing In Battle Over Optional Federal Chartering; Flurry of letters from opposing industry associations push to get or keep state chiefs on their side*, National Underwriter Property & Casualty/Risk & Benefits Management Edition, Sept. 17, 2007.

Another complicating factor is the decision in [Watters v. Wachovia Bank, N.A., 127 S. Ct. 1559 \(U.S. 2007\)](#), which held that state consumer protection laws were preempted by the National Bank Act, [12 USCS § 1](#) et seq. There have been many comparisons to the banking industry where both federal and state chartered banks are allowed. Nevertheless, it is unclear to what extent state consumer protection laws affecting insurance companies would apply to nationally chartered insurers.

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