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Advancing Liberty – From the Economy to Ecology

November 2, 2007 **No. 1**

How an OFC Would Impact the States

A Response to Governors Sebalius and Perdue

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Two sitting state governors—Kansas Democrat Kathleen Sebalius and Georgia Republican Sonny Perdue—recently wrote to their 48 peers asking them to contact their state's "congressional delegation and urge their opposition to an Optional Federal Charter" (OFC) for insurance companies. Their letter opposes two very similar National Insurance Act bills (S. 40 and H. 3200) that have been introduced in the Senate and House respectively.

CEI does not have a position on either of these bills but we do support the concept of optional federal chartering for insurance companies. This memo attempts to provide analysis and insight on the governors' letter and describe how insurance reform might impact the states and their insurance regulatory systems. It analyzes three major claims made in the letter relating to the reach of an OFC, its impact on state tax revenues, and consumers' attitude towards insurance regulation.

Statement: "Optional Federal Charter [would exist] for the purposes of regulating the $5.6 trillion insurance industry."

Analysis: ***An OFC would not impact the entire insurance industry and, in any case, $5.6 trillion—the total value of all insurance companies—is a gross overstatement of the insurance industry's economic significance***.

The OFC bills currently before Congress would cover homeowners', automobile, and life insurance but would not include health insurance. This is important since health insurance comprises more than half of the insurance industry. In most cases, furthermore, it would have only modest impacts on very large commercial accounts.

Net earned property and casualty premiums—the conventional measure of industry size—were $435 billion in 2006 according to the Insurance Information Institute. While insurance ranks among the nation's most significant industries and provides an important economic engine for many states, it's important to have proper perspective of its significance. An OFC would not impact nearly half of the $14 trillion U.S. economy as the governors imply it would.

Statement: “Furthermore, state budgets would be impacted as a significant portion of the $16 billion in annual revenue derived from fees, assessment and premium taxes becomes at risk in order to fund a new federal bureaucracy.”

Analysis: *The governors have a legitimate fear but the current bills would not have any impact on premium taxes and likely would not create a large bureaucracy in the short term.*

Both National Insurance Act bills currently before Congress specifically give all premium taxes to state governments. State governments would, of course, also continue to collect the general business and income taxes that make up the great bulk of insurance company tax revenue. The main task of most state bureaucracies involves regulating the prices that insurance companies charge. Since the current National Insurance Acts do not envision allowing the federal government regulating rates, it’s likely that the federal insurance bureaucracy would be no larger than the insurance department of a mid-sized state.

Nonetheless, it’s possible that federal officials looking for new sources of revenue would eventually attempt to claim state premium taxes. In addition, federal bureaucracies have often grown far beyond the scope intended by their creators. State and federal officials should guard against both possibilities and the governors are right to draw attention to them.

Statement: “Most important, consumers, the constituents we serve, appear satisfied with the current level of service and protection they are receiving. A recent survey of policyholders across the country finds consumers do NOT want to call Washington to get their questioned answered.”

Analysis: ***Most Americans are dissatisfied with the current insurance environment***.

A 2007 survey from The American Consumer Institute shows a high level of dissatisfaction with current insurance regulations. Nearly 60 percent of consumers surveyed favored less overall insurance regulation (something the current OFC proposals would provide) and more than half thought that insurance regulation did not benefit consumers in their state. If consumers are deeply concerned about the source of insurance regulation—and there’s little evidence they are—an Optional Federal Charter will still give them the option of purchasing a state regulated insurance product. That’s the point of making it optional.

In short, the letter from the two governors offers a valuable perspective from state-level officials. It offers some extremely valuable cautions about how and OFC could go wrong. But, upon analysis, some of its arguments appear deeply flawed.