Financial Services & E-Commerce

Insurance Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act

*By Laura Kotelman**

In June 2009, when the President presented his Financial Reform Plan, the plan set forth six principles that the Treasury Department would support for modernizing the regulation of insurance. Those principles included:

- Effective systematic risk regulation with respect to insurance;
- Strong capital standards and an appropriate match between capital allocation and liabilities;
- Meaningful and consistent consumer protection for insurance products and practices;
- Increased national uniformity through an optional federal charter or effective action by the states;
- Regulation of insurance companies and affiliates on a consolidated basis, including non-insurance affiliates; and
- International coordination.

On July 21, 2010, the President signed into law H.R. 4173, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"). Title V of the Act implements the principles set forth in the Financial Reform Plan regarding the regulation of insurance. There are two primary initiatives in Title V that support the Financial Reform Plan's goal to modernize the regulation of insurance: establishment of the Office of National Insurance ("ONI") within the Treasury Department and the modernization of insurance regulation.

I. Overview

Subtitle A of Title V of the Act establishes the Federal Insurance Office ("FIO"), which is authorized to perform various functions with respect to all lines of insurance (excluding health insurance, certain long-term care insurance and crop insurance). Such functions include monitoring the U.S. insurance industry, recommending to the Oversight Counsel that certain insurers be subject to regulation as Designated Companies, administering the Terrorism Insurance Program established under the Terrorism Risk Insurance Act of 2002, and coordinating federal efforts on prudential aspects of international insurance matters.

Subtitle B of Title V of the Act is intended to streamline the regulation of nonadmitted insurers and surplus lines insurance by providing exclusive regulatory authority to an insured's home state. With respect to credit for reinsurance, the subtitle places limits on the ability of state regulators to supersede the regulatory primacy of a ceding company's state of domicile. Similarly, the financial solvency of a reinsurer will be regulated by its state of domicile.

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II. Subtitle A—Federal Insurance Office Act of 2010

The Act establishes the Federal Insurance Office within the Treasury Department, headed by a director appointed by the Treasury Secretary. The FIO Director will serve in an advisory capacity on the Oversight Council.

The FIO is authorized to perform the following functions with respect to all lines of insurance (excluding health insurance, long-term care insurance (other than long-term care insurance included with life or annuity components), and crop insurance):

- monitor the insurance industry, including identifying gaps in the regulation of insurers that could contribute to a systemic crisis in the insurance industry or in the U.S. financial system;
- monitor the extent to which traditionally underserved communities and consumers, minorities, and low and moderate-income persons have access to affordable insurance products;
- recommend to the Oversight Council that any particular insurer be classified as a Designated Company subject to regulation and supervision by the Federal Reserve Board pursuant to Title I of the Act;
- assist in administering the Terrorism Insurance Program;
- coordinate federal efforts and develop federal policy on aspects of international insurance matters, including representing the United States in the International Association of Insurance Supervisors and assisting the Treasury Secretary in negotiating certain agreements between the United States and one or more foreign governments, authorities, or regulatory entities regarding prudential measures with respect to the business of insurance or reinsurance (each such agreement, a "covered agreement");
- determine whether state insurance measures are preempted by covered agreements;
- consult with states and state insurance regulators regarding insurance matters of national and international importance; and
- advise the Treasury Secretary on major domestic and international insurance policy issues.

Notwithstanding the establishment of the FIO, state insurance regulators will remain the primary regulatory authority over insurance. No optional federal insurance charter is established. The Act specifically withholds from the FIO and the Treasury Department general supervisory or regulatory authority over the business of insurance.

In connection with its performance of the functions listed above, the FIO may receive and collect data on and from the insurance industry for analysis and dissemination, and may require, by subpoena, an insurer meeting a minimum size threshold (to be established by the FIO) to submit such data to the FIO.

The FIO may determine that a state insurance measure may be preempted if such measure: (1) results in less favorable treatment of a non-U.S. insurer than a U.S. insurer domiciled, licensed, or otherwise admitted in the relevant state and (2) is inconsistent with a covered agreement.

Certain reports must be submitted to specified congressional committees and to the President by the FIO Director. Specifically, the Act requires submission by the FIO Director to certain House and Senate committees of:

- a report and recommendations on how to modernize and improve the system of insurance regulation in the United States;
- annual reports on the insurance industry and on any actions taken by the FIO regarding preemption of state law;
- a report on the global reinsurance market and its role in supporting insurance in the United States; and
- a report, and an update of such report, describing the impact of the Nonadmitted and Reinsurance Reform Act of 2010.

III. Subtitle B: Nonadmitted and Reinsurance Reform Act of 2010

The Act is intended to streamline the regulation of nonadmitted insurers and surplus lines insurance (which generally does not include certain workers' compensation insurance) by providing exclusive regulatory authority to an insured's home state and promoting uniformity of requirements and standards among states.

Among other provisions, the Act specifically provides that:

- where risks are located in multiple states, only the home state of an insured may require any premium tax payment for nonadmitted insurance; however, the states may establish procedures to allocate such premium taxes among relevant states;
- only an insured's home state may require a surplus lines broker to be licensed in order to sell, solicit, or negotiate nonadmitted insurance with respect to such insured;
- unless a state has adopted nationwide uniform requirements and procedures (to be developed in accordance with this Subtitle of the Act), a state may only impose eligibility requirements on nonadmitted insurers domiciled in a U.S. jurisdiction in conformance with the requirements set forth in the National Association of Insurance Commissioners ("NAIC") Nonadmitted Insurance Model Act;
- if a nonadmitted insurer domiciled outside the United States is listed on the NAIC Quarterly List of Alien Insurers, a state may not prohibit a surplus lines broker from placing nonadmitted insurance with, or procuring nonadmitted insurance from, such insurer; and
- if certain specified and requested information is provided, a surplus lines broker seeking to procure or place nonadmitted insurance in a state for certain large commercial insureds shall not be required to satisfy any state requirement to make a due diligence search to determine whether coverage can be obtained from an admitted insurer.

Additionally, the Act regulates certain reinsurance matters by prohibiting any state, other than the domiciliary state of the ceding company, from denying credit for reinsurance if the state of domicile of the ceding company is National Association of Insurance Commissioners ("NAIC") accredited or has financial solvency requirements substantially similar to the NAIC accreditation requirements.

The Act also delegates sole responsibility for the regulation of a reinsurer's financial solvency to such reinsurer's state of domicile, provided such state is NAIC-accredited or has financial solvency requirements substantially similar to the NAIC accreditation requirements.

Where a ceding insurer's domiciliary state recognizes such credit for reinsurance and such state is NAIC accredited or has financial solvency requirements substantially similar to the requirements necessary for NAIC accreditation, no other state may deny credit for reinsurance to the ceding insurer.

The Director shall submit to the President and to certain congressional committees a report on the insurance industry and a report regarding any actions taken by the FIO regarding preemption of state law.

IV. Conclusion

While the Dodd-Frank Wall Street Reform and Consumer Protection Act established the Federal Insurance Office, the Office is not a regulator or supervisor. Insurance is and continues to be primarily regulated by the individual states. Congress ultimately limited the scope of the Federal Insurance Office and recognized that it should not be a duplicative federal insurance regulator. The office monitors the insurance industry and develops federal policy on prudential aspects of international insurance matters. The states will continue to be the laboratories of democracy when it comes to the regulation of insurance, and the nation will continue to have a patchwork of fifty-one sets of laws governing insurers. While the FIO is restricted primarily to monitoring the industry and advising Congress and federal agencies on insurance issues, federal regulators will still have vast discretion over how this oversight is executed.

With regard to the Nonadmitted and Reinsurance Reform Act, the NAIC Surplus Lines Implementation Task Force developed a coordinated state response called the Nonadmitted Insurance Multi-State Agreement (NIMA). For many years, the insurance industry educated Congress on the need and benefit of the NRRA to create a streamlined tax system that involved uniform requirements, forms, and procedures. NIMA not only fails to address that uniformity standard, but it creates an uncertain taxing arrangement when the state response to NRRA should adhere to the full intent of Dodd-Frank Act, including the uniformity of requirements, forms, and procedures applicable to nonadmitted insurance business.

As federal regulators draft rules implementing Title V of the Act, a careful approach to adding federal oversight to the state-based insurance regulatory system is required in order to avoid unnecessary bureaucracy where adequate safeguards for consumers are already in place.