STROOCK
SPECIAL BULLETIN

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

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On June 30, 2010, the House of Representatives approved, by a vote of 237 to 192, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Bill").[1] The Senate, however, will not consider the Bill until after the July 4th recess. Although the Bill, and its many iterations over the past year, have attracted attention principally for the proposed overhaul of the regulation of financial institutions, it contains several provisions that would directly affect insurance regulation in the United States. In particular, portions of the Bill, as passed by the House, are an expression of long-standing efforts to streamline the regulation of surplus lines insurance and reinsurance by designating the home state (*e.g.*, principal place of business) of a surplus lines insured and the domiciliary state of a reinsurer as the sole regulator for most purposes. The Bill also would create a Federal Insurance Office ("FIO") within the Department of the Treasury to promote national coordination in the insurance industry.

This **Stroock Special Bulletin** briefly summarizes provisions of the Bill that would have a direct and significant effect on the insurance industry, discusses some of the ways in which these provisions could affect the current state of insurance regulation in the United States, and examines certain insurance industry reactions to these legislative initiatives.

Surplus Lines Insurance and Reinsurance Provisions

Significant provisions of the Bill relating to insurance include those dealing with surplus lines insurance and reinsurance. The Bill attempts reshape the current system of multiple and overlapping state regulatory authority by assigning primary regulatory authority to an insured's home state in the case of surplus lines insurance and, to a lesser extent, the reinsurer's domiciliary state in the case of reinsurance. These provisions, which are substantially identical to those contained in the

Nonadmitted and Reinsurance Reform Act of 2009 and previously passed by the House on September 9, 2009, would take effect one year after the Bill's enactment.

Surplus Lines Insurance

The Bill provides that surplus lines insurance will be subject solely to the statutory and regulatory requirements of the insured's home state, except with respect to certain workers' compensation coverages. The Bill defines the insured's home state as (a) the state in which the insured maintains its principal place of business or (b) if 100% of the risk is located outside of the state of the insured's principal place of business, the state to which the greatest percentage of the insured's taxable premium for the insurance is located. In addition, the Bill would do the following:

- prohibit any state from establishing eligibility criteria for United States-domiciled surplus lines insurers except in conformance with the National Association of Insurance Commissioners (the "NAIC") Non-Admitted Insurance Model Act (unless the state has adopted alternative nationwide uniform requirements);

- eliminate state requirements that surplus lines brokers undertake diligence searches to determine whether coverage can be obtained from admitted insurers for "exempt commercial purchasers," subject to certain disclosure requirements and receipt of a prior written request from the exempt commercial purchaser;[2]

- prohibit any state, other than an insured's home state, from requiring a surplus lines broker to be licensed in order to sell surplus lines insurance;

- prohibit any state from collecting fees relating to the licensure of a surplus lines broker in the state unless it has a regulatory mechanism in effect for participation in the NAIC's national insurance producer database or other equivalent uniform national database;

- eliminate state prohibitions on surplus lines brokers placing business with non-United States insurers that are included on the NAIC Quarterly List of Alien Insurers;

- prohibit any state, other than an insured's home state, from requiring premium tax payments for surplus lines insurance and permit states to develop an interstate compact to provide for allocation and remittance procedures; and

- require the Comptroller General of the United States to conduct a study to determine the effect of the Bill on the surplus lines insurance market.

Reinsurance

The Bill would prohibit non-domiciliary states from denying credit for reinsurance if the domiciliary state of a ceding insurer is an NAIC-accredited state or has solvency requirements substantially similar to those required for NAIC accreditation. The Bill also would prohibit non-domiciliary states from applying any requirements to reinsurance transactions that back risks in their states, except for those relating to the collection of taxes and assessments. In addition, the domiciliary state of the reinsurer would be solely responsible for regulating the financial solvency of the reinsurer, and non-domiciliary states could not require a reinsurer to provide financial information other than that which the reinsurer is required file with its domiciliary state.

As a result, if a reinsurer domiciled in Delaware, for example, were determined by Delaware to be financially sound, and that reinsurer provided reinsurance to a ceding insurer domiciled in Connecticut, and Connecticut granted credit to the ceding insurer for that reinsurance, then New York would not be permitted to deny credit for reinsurance shown on the ceding insurer's books.

Precedent for the Bill's surplus lines insurance and reinsurance preemption provisions can be found in the federal preemption of non-domiciliary state regulators for risk retention groups formed under the Liability Risk Retention Act of 1986 (the "LRRA").[3] The LRRA permits a qualified risk retention group to provide product liability insurance in all states, free of insurance regulation by non-domiciliary states, if it complies with the insurance laws of its chartering state. As compared to surplus lines insurance and reinsurance, however, risk retention groups represent a small segment of liability risks.

The overall impact on the insurance market of allowing surplus lines and reinsurance transactions to be governed exclusively by a single state regulator, with all other state laws and regulations being preempted, could be substantial, especially because surplus lines brokers would be free to place certain risks without any requirement that they show the inability of admitted insurers to cover those risks. Still, enforcement of the Bill's preemption provisions could prove problematic because the Bill does not assign responsibility for ensuring that states respect those provisions to any federal agency. Using risk retention groups as an example, they have sometimes found that non-domiciliary states impose restrictions on their operations in ways prohibited by the LRRA. In such cases, litigation or acquiescence to apparently unlawful state regulation are the only available options.

Federal Insurance Office

The principal functions of the FIO established by the Bill would be to monitor the insurance industry, collect data on insurance activities, advise the Financial Stability Oversight Council with regard to potential systemic risk by any insurer, and represent the United States at international meetings concerning insurance. Notably, the FIO is not authorized to preempt any state regulation of insurance rates, premiums, underwriting practices, sales, solvency or antitrust matters. The only exception is where a state practice would either violate an international regulatory agreement to which the United States is a party or treat a non-United States insurer subject to such an agreement less favorably than a domestic insurer. Even then, however, the FIO would first have to notify and consult with relevant state regulators.

The establishment of the FIO could portend increased federal involvement in the insurance industry. The Bill would require that FIO report to Congress within 18 months of the Bill's enactment on how insurance regulation could be modernized, including how to achieve uniformity in state regulation, whether federal regulation of some lines of insurance would be practicable, and whether the federal government should become more involved in consumer protection. Assuming both that the FIO report would call for increased federal involvement in insurance regulation and that Congress would respond positively to that report, then legislation imposing greater federal authority over insurance matters could be a future possibility.

Insurance Industry Reactions

Some industry insiders regard the Bill's surplus lines provisions as a victory years in the making. The National Association of Surplus Lines Offices ("NAPSLO") has long argued for uniform licensing standards, ease of commercial access, and the simplification of premium tax payments. Commenting on the prior Nonadmitted Insurance and Reinsurance Reform Act, NAPSLO's Executive Director, Richard Bouhan, stated that the provisions would make the placement of multistate risks "easier, less treacherous and less costly for the surplus lines broker." Many industry experts believe single-state compliance will also reduce the sizable transaction costs associated with complex, multistate regulations. For example, a recent American Association of Managing General Agents study estimated multistate compliance overhead expenses at between $70 million and $100 million.

The Bill's establishment of the FIO, however, has made some industry insiders squeamish. David Sampson, president and CEO of the Property Casualty Insurers Association of America, expressed concerns that additional federal regulation may impose undue burdens upon insurers. He stated that "[d]uplicative federal oversight threatens to add costs to the insurance marketplace without corresponding benefits to the consumer. It also creates potential conflicts with existing state regulatory protections."

Recent changes to the legislation reflected in the current Bill would require that the FIO first seek out data from state regulators and peer federal agencies before pursuing further reporting obligations for insurance companies. Such provisions, which would limit federal oversight, give industry insiders comfort. "In most instances the legislation appropriately recognizes that our industry does not pose a systematic risk," observed Leigh Ann Pusey, President and CEO of the American Insurance Association.[4]

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1. The full text of the Bill is available at http://financialservices.house.gov/Key_Issues/Financial_Regulatory_Reform/conference_report_FINAL.pdf.

2. The Bill defines an "exempt commercial purchaser" as any person who (a) employs or retains a "qualified risk manager" to negotiate coverage, (b) has paid aggregate commercial property and casualty premiums in excess of $100,000 in the immediately preceding 12 months, and (c) meets one of another set of certain criteria (net worth of $20 million, annual revenue in excess of $50 million, employs more than 500 people, etc.). The Bill further provides that a "qualified risk manager" must meet all of the following requirements: (a) be an employee of, or third-party consultant retained by, the commercial policyholder; (b) provide "skilled services in loss prevention, loss reduction or risk and insurance coverage analysis and purchase of insurance"; and (c) meet certain requirements focusing on education, designations, and experience in the insurance industry.

3. 15 U.S.C. § 3901 et seq.

4. Arthur D. Postal, "P & C Groups Support House-Passed Finance Reform Bill," *National Underwriter Property and Casualty News* (July 2, 2010), available at http://www.property-casualty.com/News/2010/7/Pages/PC-Groups-Support.aspx.

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