Federal Insurance Regulatory Round-Up: Goals to Reform U.S. Insurance Regulatory System Sidetracked by Busy Congressional Agenda

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The worldwide financial meltdown in the fourth quarter of 2008 caused many to call for broad reforms in the regulation of the U.S. financial services industries. Systemic problems encountered by some of the largest and most well recognized U.S. insurance holding company groups led to renewed calls to reform the existing state based system of insurance regulation. Many industry observers predicted that the financial crisis would serve as the catalyst that would cause Congress to adopt insurance regulatory reform measures that it has been discussing for the last several years.

2009 started with considerable discussion in Congress regarding reforms of the regulation of the financial services industry generally and the U.S. insurance industry specifically. The attention of the Congress, however, was gradually diverted by other high profile issues including the financial crisis and federal bailout proposals, the wars in Iraq and Afghanistan, climate change and, of course, health care reform. Despite the overwhelming agenda facing the 111th Congress, several bills to reform the U.S. insurance regulatory system were proposed in Congress. This article summarizes and provides the status of some of the more prominent proposals. We do not address, however, the various proposals to reform the U.S. health care and insurance systems, as this multi-faceted and emotionally charged topic does not lend itself well to summarization.

The proposals introduced in Congress this year seeking to reform the U.S. insurance regulatory system generally fall into two categories:

(1) proposals to create an optional federal system of insurance regulation; and

(2) targeted proposals to reform specific aspects of the current U.S. insurance regulatory framework.

1. **Optional Federal Charter**

National Insurance Consumer Protection Act of 2009

On April 2, 2009, Representatives Melissa Bean (D-IL) and Ed Royce (R-CA), introduced H.R. 1880, the National Insurance Consumer Protection Act of 2009 (the NICPA) in the U.S. House of Representatives. The NICPA, much like its predecessors the National Insurance Act of 2006 and the National Insurance Act of 2007, would establish an optional system of federal regulation and supervision of insurance under the newly created Office of National Insurance (ONI). As part of the U.S. Department of the Treasury, the ONI would be headed by a National Insurance

Commissioner, which would be a Presidential appointment requiring the confirmation of the Senate.

The NICPA would be similar to the dual bank regulatory system in the U.S. under which banks can be chartered and regulated under federal law or state law. Under the NICPA, insurance companies and entity producers could obtain a national charter and be regulated and licensed by the ONI as a national insurer or national insurance agency. Individual licensed insurance producers could also select to be licensed and regulated by the ONI as national insurance producers. Alternatively, insurance companies, entity and individual producers could be licensed and regulated under state law.

The ONI would supervise national insurance companies and individual and entity producers by setting rules and regulations and issuing orders and interpretations with regard to their financial activities and market conduct. The ONI would consist of several offices and divisions. The Division of Consumer Affairs would (i) act as a liaison between the ONI and consumers; (ii) receive questions or complaints from consumers regarding national insurance companies and national entity and individual producers; and (iii) take actions in response to such questions and complaints. The Office of the Ombudsman would act as a liaison between the ONI and national insurance companies and national entity and individual producers that are adversely affected by the supervisory or regulatory activity of the ONI. The Division of Insurance Fraud would carry out investigations of insurance fraud.

Under the NICPA, state regulators would maintain responsibility for supervising state-licensed insurance companies and producers while nationally chartered and licensed entities would be regulated primarily by federal law, with the exception of: (i) state tax laws; (ii) state unclaimed property and escheat laws; (iii) state laws related to participation in assigned risk plans, mandatory joint underwriting associations, or any other mandatory residual market mechanisms; (iv) state laws that prescribe compulsory coverage of workers' compensation or motor vehicle insurance; (v) state laws mandating participation of insurers in an advisory or statistical organization, except to the extent such law mandates a national insurer to use any particular rate, rating element, price, or form; and (vi) participation in state guaranty funds.

The NICPA establishes standards and would provide the ONI with the authority to place financially impaired national insurers into receivership for rehabilitation or liquidation. Also under the direction of the ONI would be the newly created National Insurance Guaranty Corporation (the NIGC). National insurance companies would be required to participate in the NGIC and pay assessments. Assessments would be used to pay claims pursuant to the terms and limits of the Post-Assessment Property and Liability Insurance Guaranty Association Model Act of the National Association of Insurance Commissioners (NAIC), for property and casualty claims, and the NAIC Life and Health Insurance Guaranty Association Model Act, for life and health insurance claims. National insurance companies would also be required to participate in state guaranty associations.

The ONI would also have supervision over national insurance holding companies – companies that control a national insurance company or national entity producer – to monitor them for activity that the ONI determines to pose a significant risk to the solvency of a national insurer, jeopardizes the interests of the policyholders, or is incompatible with the public interest.

Under the NICPA, the President would designate a Systemic Risk Regulator (the SSR), which would be separate from the ONI. If the SSR identifies conduct of a national insurance company that could potentially have adverse effects on economic conditions or financial stability, it would make recommendations to the ONI or state insurance regulatory authorities regarding corrective actions. If the ONI or state insurance authority should fail to implement such corrective action, the SSR may issue rules or orders to address the conduct that poses the risk. Additionally, the SSR, in consultation with the ONI, is charged with the duty to determine if an insurer is systemically important, and if so, whether the insurer should be required to be chartered under the NICPA.

The NICPA also contemplates the creation of a Coordinating Council for Financial Regulators (the Council). The Council would serve as a forum for financial regulators to identify, consider, and make recommendations regarding issues related to the regulation and supervision of financial services firms, including the stability and integrity of financial markets, investor and consumer protection, and the efficiency and effectiveness of regulation and supervision. The eleven person Council would consist of the Secretary of the Treasury as its chair, the Chairman of the Board of Governors of the Federal Reserve System, the Chairman of the Securities and Exchange Commission, the Chairman of the Commodities Futures Trading Commission, the Comptroller of the Currency, the Director of the Office of Thrift Supervision, the Chairman of the Federal Deposit Insurance Corporation, the Commissioner of the ONI, and three individuals (one banking, one insurance, and one securities expert) appointed by the President with the advice and consent of the Senate. In addition, the Council, by a two-thirds vote of its membership, would be able to determine that corrective action by the SSR is necessary if it would mitigate or avoid an impending serious adverse effect on economic conditions or financial stability in the United States.

The NICPA was referred to the House Committee on Financial Services, the Judiciary Committee and the Energy and Commerce Committee and is awaiting review. Although introduced with much fanfare in the spring, with other consumer protection bills filling the Congressional calendar, it appears unlikely that the NICPA will advance out of committee for a floor vote by year-end.

2. Targeted Reform Proposals

National Association of Registered Agents and Brokers Reform Act of 2009

On May 21, 2009, three important pieces of insurance industry legislation, which failed to pass both the House and the Senate in previous years, were reintroduced in the House. One of the three, H.R. 2554, the National Association of Registered Agents and Brokers Reform Act of 2009 (NARAB), was introduced by Representative David Scott (D-GA). The bill is similar to its 2008 predecessor in that it seeks to amend the Gramm-Leach-Bliley Act to establish a national association to provide multi-state licensing to insurance producers. While the proposed legislation aims to make uniform the qualifications and conditions to obtain an insurance producer license, it retains the authority of the states to regulate insurance producers, including the licensing, supervision, trade practices, discipline, and licensing fees applicable to producers. Under the proposal, once an insurance producer becomes a member of NARAB, the insurance producer will be authorized to sell, solicit, negotiate, effect, procure, deliver, renew, continue, or bind insurance in any state for all lines of insurance authorized under the insurance producer's home state license.

NARAB is widely supported with 44 co-sponsors and is currently being reviewed by the House Financial Services Committee. Although this bill has the support of the NAIC, the Independent Insurance Agents and Brokers of America (IIABA), the National Association of Insurance and Financial Advisors (NAIFA), and the Council of Insurance Agents and Brokers (CIAB), it is unlikely that it will be passed into law this year due to the busy Congressional agenda.

Nonadmitted and Reinsurance Reform Act of 2009

The second insurance regulatory bill reintroduced in the House on May 21, 2009 was H.R. 2571, the Nonadmitted and Reinsurance Reform Act of 2009. The bill is sponsored by Representative Dennis Moore (D-KS), and on June 25, 2009, its companion bill, S. 1363 was reintroduced into the Senate by Senators Evan Bayh (D-IN) and Mel Martinez (R-FL). On September 9, 2009, the House passed H.R. 2571, making it the third straight time the House has voted to pass a version of this legislation.

As with earlier versions, H.R. 2571 and S. 1363 would give regulatory oversight of nonadmitted insurance to the insured's home state, and only the home state may levy a premium tax for nonadmitted insurance or require a surplus lines broker to be licensed. The bills are intended to foster uniformity among state laws with respect to premium tax allocation and eligibility criteria for nonadmitted insurers. The bills also grant direct access to the surplus lines market for sophisticated commercial purchasers.

With regard to reinsurance, the bill proposes, in most instances, to have reinsurers subject only to the solvency rules of their state of domicile. The bill also prevents a state from denying credit for reinsurance if the domiciliary state of the insurer purchasing reinsurance allows credit for reinsurance and (i) is either an NAIC-accredited state; or (ii) has financial solvency requirements substantially similar to NAIC accreditation requirements.

While this bill has advanced further than any other bill discussed in this article, due to its history of repeatedly passing in the House, but not in the Senate, it is difficult to predict whether it will be passed this year.

Federal Insurance Office Act of 2009 (f/k/a Office of Insurance Information Act of 2009)

The third piece of insurance regulatory legislation reintroduced to the House on May 21, 2009, was H.R. 2609, the Insurance Information Act of 2009, which proposes to establish an Office of Insurance Information (the OII) in the U.S. Department of the Treasury. H.R. 2609, was introduced by Representative Kanjorski (D-PA). Similar to its 2008 predecessor, this bill would allow the OII to collect and study insurance data and advise the Department of Treasury and Congress on domestic and international policy-making regarding insurance. The bill would also establish an advisory council of regulators and consumer groups to inform the leader of the OII.

Representative Kanjorski released a revised discussion draft of H.R. 2609 on October 1, 2009 called the Federal Insurance Office Act.

The previous version included language stating that nothing in the proposed law "may be construed to establish a general supervisory or regulatory authority of the Office [of Insurance Information] or the Department of Treasury over the business of insurance." Aside from changing the name of the proposed office to the Federal Insurance Office (FIO), it is significant to note that the discussion draft does not include this language. Advocates of state insurance regulation have taken umbrage with this and view it as a step towards creating a federal insurance regulator.

The discussion draft also differs from earlier versions in that the FIO will recommend to the Board of Governors of the Federal Reserve System that certain insurers be designated as entities subject to regulation as a Tier 1 financial holding company under the Bank Holding Company Act.

While the previous version enjoyed wide support from industry groups including the NAIC and the National Association of Mutual Insurance Companies, according to recent testimony given before the House Financial Services Committee, the new draft has caused many supporters of the previous version to oppose H.R. 2609. Given the ire this discussion draft has created, it is uncertain whether the draft or a version that more resembles the bill introduced in May will make it out of committee and to a floor vote by the end of the Congressional session.

The Neal Bill 2009

On July 31, 2009, Rep. Richard Neal (D-MA) introduced legislation to repeal a controversial tax deduction used by foreign reinsurers. The bill, H.R. 3424, is very much like its predecessor introduced in 2008 in that it would disallow tax deductions by U.S.-domiciled insurers and reinsurers for the excess reinsurance premiums ceded to affiliated insurance companies not subject to U.S. taxation. Premiums would be deemed excessive when the cessions are greater than the industry average of reinsurance paid to unrelated parties. According to Rep. Neal, by limiting the deduction to the industry average, the excess reinsurance premiums paid to affiliated reinsurers will remain in the reach of U.S. taxation and, thus, eliminate any competitive advantages for a foreign insurance group. The bill has been referred to the House Committee on Ways and Means.

While the Obama Administration continues to work to eliminate perceived off-shore tax abuses, the Neal Bill, which focuses narrowly on the insurance industry, has not received much attention in Congress. However, with Congressional leaders appearing likely to pursue legislative reform proposals relating to international taxation, H.R. 3424 may make it out of committee for a floor vote or perhaps be integrated into similar proposals that address the taxation of related party transactions.

Repealing the McCarran-Ferguson Act

On March 18, 2009, Representative Gene Taylor (D-MS) introduced H.R. 1583, the Insurance Industry Competition Act of 2009. H.R. 1583 seeks to remove the anti-trust exemption for insurers from the McCarran-Ferguson Act and give the Department of Justice and the Federal

Trade Commission the authority to apply federal antitrust laws against insurers for purported anticompetitive behavior. H.R. 1583 was referred to the House Judiciary Committee, the Energy and Commerce Committee and the Financial Services Committee and is awaiting review.

Similar to H.R. 1583, but narrowly tailored to health insurers and medical malpractice insurance issuers, is the Health Insurance Industry Antitrust Enforcement Act of 2009, which was introduced into both the House as H.R. 3596 by Representative John Conyers (D-MI) and the Senate as S. 1681 by Senator Patrick Leahy (D-VT) on September 17, 2009. According to Representative Conyers, the proposed legislation would "specifically prohibit price fixing, bid rigging, and market allocation in the health insurance industry." Using S. 1681 as a tool to force the hand of health insurers in the debate over national healthcare reform, Senator Leahy stated on the Senate floor that "the health insurance industry currently does not have to play by the same, good-competition rules as other industries."

While the fate of healthcare reform appears to depend on highly politicized subjects such as a public option or "death panels," a partial repeal of the McCarran-Ferguson Act could possibly find its way into any one of the proposed healthcare reform packages if Congressional leaders find it necessary to achieve the goal of providing coverage to people without health insurance and lowering the cost of healthcare in the United States.

Outlook

Representative Barney Frank (D-MA), chairman of the House Financial Services Committee, has consistently maintained that major financial services industry reform legislation will be brought to the House floor for a vote by year-end. This could be either in the form of a single sweeping bill or several smaller pieces of legislation. Senator Christopher Dodd (D-CT) has maintained similar hopes. However, both have publically acknowledged that a crowded legislative agenda means that a vote on many of the current proposals may likely be moved to 2010.