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Dodd-Frank Wall Street Reform and Consumer Protection Act Will Make Significant Changes in State Insurance Regulation

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Insurance is not the central focus of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"), which President Obama signed into law on July 21, 2010 (Public Law 11-203). However, the Act contains provisions that are likely to have a direct and long-term impact upon state regulation of insurance, reinsurance and nonadmitted insurance.

A. Office of National Insurance

Title V of the Act establishes a Federal Insurance Office ("FIO") within the Department of the Treasury, headed by a Director appointed by the Secretary of the Treasury. The FIO is authorized to (a) monitor the insurance industry and identify issues or gaps that could contribute to a systemic crisis in that industry or the U.S. financial system; (b) monitor the extent to which underserved communities, minorities and low- and moderate-income persons have access to affordable insurance products for lines of insurance other than health insurance; (c) recommend to the Financial Stability Oversight Council that an insurer should be designated as an entity that is subject to regulation as a nonbank financial company supervised pursuant to Title I of the Act; (d) assist in the administration of the Terrorism insurance program; (e) coordinate federal efforts and develop federal policy on prudential aspects of international insurance matters, including representing the United States in the International Association of Insurance Supervisors and assisting the Secretary of the Treasury in negotiating "covered agreements"[1] between the United States and foreign governments, authorities and regulatory agencies; (f) determine whether state laws are preempted by such agreements; (g) consult with states on insurance matters of national significance and those prudential insurance matters of international importance; and (h) perform other duties as assigned by the Secretary of the Treasury. The Director will serve in an advisory capacity on the Financial Stability Oversight Council.

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The foregoing authority extends to all lines of insurance other than health insurance, long-term-care insurance (except where included with life or annuity components) and crop insurance. In carrying out these activities, the FIO may collect information from insurers (other than those insurers that meet a "small insurer" size threshold that the FIO establishes by order or rule) and enter into information-sharing arrangements. However, it must first try to obtain the information from public sources or from state insurance regulatory agencies.

State insurance regulation is preempted if the FIO determines that its application (a) results in the less favorable treatment of an insurer domiciled in a jurisdiction outside the United States which has a covered agreement in effect than would be the case for a U.S. insurer domiciled, licensed or admitted in the state; and (b) is not consistent with the covered agreement. Preemption is limited to subject matter that is contained within the covered agreement and its application must afford a level of protection for consumers that is substantially equivalent to that achieved under the state regulation in question. Where a determination regarding preemption is subject to judicial review, the matter shall be determined de novo by the court.

The Act does not provide for preemption of requirements regarding rates, premiums, underwriting or sales practices, coverage requirements, the application of state antitrust laws or state capital or solvency measures that do not discriminate against insurers domiciled outside the United States. In addition, the FIO is not given general supervisory or regulatory authority over the business of insurance.

The Director is required to conduct a study within 18 months on how to modernize and improve the system of insurance regulation in the United States. This study should include the impact of subjecting insurance other than health insurance to federal regulation, and the impact such regulation could have on the operation of state guarantee funds, policyholder protection, the possible loss of life insurance special separate account status and on the international competitiveness of insurance companies.

B. State-Based Insurance Reform

Title V also includes the Nonadmitted and Reinsurance Reform Act of 2010 ("NRRA"), which takes effect on the expiration of the 12 month period beginning on the Act's date of enactment and makes direct changes in certain aspects of existing state insurance regulation.

Nonadmitted Insurance

The nonadmitted insurance part of the NRRA establishes certain preemptive standards regarding the placement of insurance with nonadmitted insurers (i.e., excess lines/surplus lines insurance). No state other than the "home state" (the state where an insured has its principal place of business or, if 100% of the insured risk is located outside that state, the state with the greatest allocated percentage of taxable premium for the insurance policy) may require a premium tax payment for the insured's nonadmitted insurance.[2] States may enter into a compact or otherwise establish procedures to allocate premium taxes paid to the home state. It contemplates uniform state requirements for reporting, payment, collection and allocation of premium taxes.

The placement of nonadmitted insurance, including the licensing of insurance brokers that sell it, is intended to be subject solely to the statutory and regulatory requirements of the insured's home state. No other state may require a surplus lines broker to be licensed in order to sell, solicit or negotiate nonadmitted insurance with respect to such insured. State law, regulation provision, or action of any state that applies to nonadmitted insurance sold to, solicited by or negotiated with an insured whose home state is another state shall be preempted.

Beginning two years after the date of the enactment of the NRRA, states that do not participate in the national insurance producer database of the National Association of Insurance Commissioners ("NAIC") or an equivalent national database are prohibited from collecting any fees for the licensing of surplus lines brokers.

A state may not establish eligibility criteria for nonadmitted insurers domiciled in a U.S. jurisdiction except in conformity with Sections 5A(2) or 5C(2)(a) of the NAIC Nonadmitted Insurance Model Act, unless it has adopted nationwide uniform requirements, forms and procedures in accordance with the NRRA. A state may not prohibit a surplus lines broker from placing nonadmitted reinsurance with or procuring such insurance from a nonadmitted insurer domiciled outside the United States and listed on the NAIC international insurers Department Quarterly Listing of Alien Insurers. A surplus lines broker need not make a search for coverage with an admitted insurer if the insured is an "exempt commercial purchaser" that meets specified criteria and has either been advised that the coverage could be obtained from an admitted carrier or has subsequently requested in writing that the broker procure insurance from a nonadmitted insurer.

The GAO must, in consultation with the NAIC, conduct a study and submit a report to Congress within 30 months from the effective date of the NRRA regarding the effect on the size and market share of the nonadmitted market for coverage typically provided by the admitted market.

Reinsurance

Part II of the NRRA establishes standards and requirements for reinsurance credit on insurer financial statements and preempts state law. States are prohibited from denying reinsurance credit for an insurer that has ceded risk if the domiciliary state of the ceding insurer recognizes such credit and (a) is an NAIC-accredited state, or (b) has financial solvency requirements substantially similar to NAIC accreditation requirements. Extraterritorial application of the laws of a nondomiciliary state (except those relating to taxes and assessments on insurers or insurance income) is preempted to the extent that such laws (a) restrict or eliminate the right of a ceding or assuming insurer to utilize arbitration that is not inconsistent with federal law to resolve disputes; (b) require that a certain state's law govern the reinsurance contract, its requirements or any disputes that arise; or (c) attempt to enforce a reinsurance contract on terms different than those set forth therein, provided that the contract terms are not inconsistent with this Part.

A reinsurer's domiciliary state has the sole responsibility for regulating its financial solvency if that state is either NAIC accredited or has financial solvency requirements substantially similar to those of the NAIC. No other state can require the reinsurer to provide any additional financial information other than information it is required to file in its domiciliary state.[3] However, such state may receive any financial statement filed with the reinsurer's domiciliary state. As such, application of provisions of state law deeming it a "commercial domicile" of an insurer domiciled in another state would appear to be preempted.

Further details and interpretations of certain provisions will become available as the implementation process moves forward. We will report on developments as they arise.

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[1] The term `covered agreement' means a written bilateral or multilateral agreement regarding prudential measures with respect to the business of insurance or reinsurance that (A) is entered into between the United States and one or more foreign governments, authorities, or regulatory entities; and (B) relates to the recognition of prudential measures with respect to the business of insurance or reinsurance that achieves a level of protection for insurance or reinsurance consumers that is substantially equivalent to the level of protection achieved under state insurance or reinsurance regulation.

[2] The term "nonadmitted insurance" means any property and casualty insurance permitted to be placed directly or through a surplus lines broker with a nonadmitted insurer eligible to accept such coverage.

[3] The term "domiciliary state" means the state where the insurer or reinsurer is incorporated or entered through.

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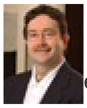 Jeremiah P. Sheehan Mr. Sheehan has had extensive experience in insurance and regulatory matters and has represented a broad range of clients in connection with the financing, acquisition and regulation of life, health and property-casualty insurers and related entities. He has represented clients on a wide range of matters before state insurance departments.