



SECURITIES INDUSTRY PRACTICE

ALERT

DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT: IMPLICATIONS FOR INSURERS, REINSURERS, PRODUCERS AND BROKERS

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) was enacted by Congress and signed into law by President Barak Obama on July 21, 2010. Dodd-Frank is a comprehensive overhaul and restatement of the U.S. financial regulatory system with implications for the insurance industry. The sections that are specific to insurance are:

- Title V Insurance, Section 501, the “Federal Insurance Office Act of 2010;”
- Subtitle B is State Based Insurance Form now known as Non-Admitted and Reinsurance Reform Act of 2010 with special treatment for Reinsurance (Part II, Section 531); and
- Part III, Rules of Construction.

Lines of Insurance

First we will identify and define in general terms which lines of insurance are governed by Dodd-Frank. The newly established Federal Insurance Office (FIO) and its director shall have authority over all lines of insurance except health insurance, long term care insurance (except long-term care insurance included with life or annuity insurance) and crop insurance, which is governed by the Federal Crop Insurance Act. A Risk Retention Group is excluded in the Section addressing non-admitted insurers. Workers’ compensation is not pre-empted with respect to non-admitted insurers. Stated

otherwise, Dodd-Frank applies to the following lines of insurance:

- Property and casualty;
- Life;
- Surety;
- Reinsurance;
- Excess and surplus lines; and
- Producers and brokers involved in intermediation.

Although new agencies are created by Dodd-Frank, expanded authority is extended to federal financial regulatory agencies including the Department of Treasury, Board of Governors of the Federal Reserve System, Office of Controller of the Currency, Office of Thrift Supervision, Securities and Exchange Commission, Commodity Futures Trading Commission, Federal Deposit Insurance Corporation, Federal Housing Finance Agency and National Credit Union Administration.

The Crucial Question Presented and Answered

The important question every insurer or state regulator has on his or her mind is whether the existing state regulatory authority scheme has been pre-empted by Dodd-Frank. Stated differently, has the McCarran-Ferguson Act of 1945 been repealed? The answer to both questions is “No!”

Discussion

The McCarran-Ferguson Act is the Congressional action exempting insurance from federal regulation as a form of interstate commerce, to the degree effective regulation is undertaken by the individual states. Specifically, Section (k) Retention of Existing State Regulatory Authority (contained within Section 501, Federal Insurance Office (FIO), and Section 313) contains an emphatic provision that nothing in the Title enacting the FIO shall be construed to establish or provide the FIO or the Department of Treasury with general supervisory or regulatory authority over the business of insurance. In other words, existing state regulatory authority including the procedures set forth under the Administrative Procedures Act continue to apply to state regulation that governs insurers rates, premiums, underwriting, sales practices, risk management, capital and surplus requirements and solvency with respect to the State Insurance Guaranty Fund System, and policy holder protections remain preserved for the states. In short, nothing in Dodd-Frank pre-empts the application of the antitrust laws of any state to the business of insurance. The FIO section does contain a subtle provision that state insurance measures shall be pre-empted, if and only if the director of the FIO determines that “Covered Agreement,” meaning a written bilateral or multilateral agreement regarding prudential measures with respect to the business and operations of insurance receive disparate or unfavorable treatment of a non-U.S. insurer domiciled in a foreign jurisdiction subject to a “covered agreement,” than a U.S. insurer domiciled, licensed or otherwise admitted in a particular state. In other words, Dodd-Frank allows the director of the FIO to intervene and cause a report to be submitted (beginning September 30, 2011) when a determination of “inconsistency” is made by the director. This limitation is applied to the states, which means in this narrow circumstance, the director may trump a state regulator.

Federal Insurance Office

The Federal Insurance Office Act of 2010 creates a Federal Insurance Office (FIO) within the Department of Treasury to monitor the U.S. insurance industry. The Office is headed by a director who is appointed by the

Secretary of the Treasury. The director’s authority is to monitor the regulatory and operational aspects of the insurance industry, including identifying inconsistencies or gaps in the regulation of insurers that could ultimately contribute to a systemic crisis in the insurance industry and adversely affect the U.S. Financial System. Agencies and oversight councils are identified in the FIO. Dodd-Frank empowers the director with oversight over all insurers, insurance holding companies, affiliates and subsidiaries of insurers, and subjects each to regulation as a non-bank financial company. An example of the coordination effort is the administration of the Terrorism and Insurance Program previously enacted pursuant to the Terrorism Risk Insurance Act of 2002. The director will coordinate federal policy on domestic and international insurance matters and will consult with state insurance regulators including the National Association of Insurance Commissioners (NAIC). Data collection will be an extensive part of the FIO for all lines of insurance with the exception of health insurance, long term care insurance (excepting life or annuity insurance components) and crop insurance.

General Overview

All insurers will be required to submit data as promulgated by the director with the exception of “small insurers” that meet a minimum size threshold not yet defined by the FIO or the director. More likely than not, what Dodd-Frank has in mind is limiting improper and excessive data collection by insurance companies with low premium volume such as small county mutual insurance companies. Dodd-Frank strongly encourages information sharing between the FIO and state insurance regulators through an information sharing agreement that also preserves the “privacy” of the data collected. Dodd-Frank does empower both the Secretary of the Treasury and the director of the FIO to promulgate rules, regulations, policies and procedures in consultation with state regulators.** There is a limitation in that no state may enforce a state insurance measure to the extent such measures have been pre-empted by the Federal Insurance Office Act. State regulators are free to continue to govern insurance rates, premiums, underwriting, sales practices, licensing and claims management practices. Nothing is contained in the Dodd-Frank Act to pre-empt the

application of antitrust laws of any state to the business of insurance nor to interfere with the capital, surplus or solvency requirements of an insurer. States will continue to administer general supervisory and regulatory authority over the business of insurance, not the FIO.

****Best Business Practices and Tips****

1. Establish monthly regulatory compliance protocols.
 2. Know your state regulator.
 3. Data gathering and reporting (often times function of compliance officer).
 4. The SEC has already begun the exercise of drafting new rules and regulations consistent with the requirements in the Financial Reform Law. The expectation is that public comments will be invited before new regulations are proposed or promulgated.
 5. It is likely that amendments to Dodd-Frank may be passed by Congress in the 2010 – 2011 legislative years.
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FIO Director Reports

The director of the FIO will have the compulsory responsibility to submit annual reports to various House and Senate Committees commencing September 30, 2011, regarding the state of the insurance industry with specific consideration being given to: systemic risk regulation; capital standards, including liquidity and duration risk; consumer protection; uniformity of state regulation; and international coordination. Regulatory arbitrage as well as regulation of insurance in foreign jurisdictions are additional factors that may be contained in the director's report. For the time being, the priority status of policyholder protection and the solvency of the State Insurance Guaranty Fund Systems are required recommendations in the report. The FIO report is intended to encompass U.S. insurers as well as non-U.S. insurers when and where each are signatories to "covered agreements," which are intended to be bilateral or multilateral agreements executed among insurers or reinsurers domiciled in the United States or in a foreign jurisdiction.

State-Based Insurance Reform: "Non-Admitted and Reinsurance Reform Act of 2010:" Section 511

The Non-Admitted and Reinsurance Reform Act of 2010 is intended to apply to non-admitted insurers, reinsurers, excess and surplus lines brokers. A non-admitted insurer is an insurer not licensed to engage in the business of insurance in a particular state. This definition does not include a Risk Retention Group (RRG). Non-admitted insurance means any property and casualty insurance permitted to be placed directly or through a surplus lines broker with a non-admitted insurer eligible to accept such insurance. The definitions are important because this particular part of Dodd-Frank deals extensively with how the payment of premium taxes is to be managed. The term "premium tax" means, with respect to excess and surplus lines insurance, any tax, fee, assessment or other charge imposed by a government entity directly or indirectly based on any payment made as consideration for an insurance contract, including premium deposits, assessments, registration fees and any other compensation given in consideration for a contract of insurance. Thus, for both non-admitted insurance and the non-admitted insurer (i.e., reinsurer), premium taxes administered by the insurer, qualified risk manager or surplus lines broker with a non-admitted insurer, are now scrutinized by the Controller General of the United States, who has the authority to conduct studies of the non-admitted insurance market to determine the effectiveness of non-admitted and reinsurance regulation and market share.

Reinsurance: Section 531

Reinsurance means the assumption by the insurer of all or part of a risk undertaken originally by another insurer, known as a cedent. Reinsurers can take some comfort that state laws shall govern reinsurance contracts, disputes and wordings language. If a reinsurer is domiciled in a state having financial solvency requirements, it is that state that will be solely responsible for regulating the financial solvency of the reinsurer. The intent is to encourage single state regulation and financial reporting that will ultimately be shared by all states where the reinsurer may be licensed, with the director of the FIO having advisory and consultancy oversight.

Conclusion

The fundamental question with respect to pre-emption is addressed in the Rules of Construction (Section 541). Succinctly put, Dodd-Frank and particularly the sections on Insurance, Federal Insurance Office, State Based Insurance Reform, Non-Admitted and Reinsurance Reform Act of 2010 and Reinsurance, shall not be construed to modify, impair or supersede the application of the antitrust laws. Moreover, any implied or actual conflict between Dodd-Frank, its amendments and the antitrust laws shall be resolved in favor of the operation of the antitrust laws.

Dodd-Frank, particularly the application to the insurance industry, is both complex and complicated. The eagerness of Congress to protect the financial stability of the United States has swept the insurance industry as an institution into the Financial Stability Act of 2010. Fox Rothschild's Securities Industry Practice Group and Insurance Practice Group are ready to help clients and interested insurance companies, reinsurers and persons to assure compliance with the Dodd-Frank Wall Street Reform and Consumer Protection Act.

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