

becoming authorized or by seeking to make use of an available exception to licensing, insurers should consider the following five issues that often are not generally known regarding New York:

1. New York's Substantial Compliance Rule

Notwithstanding that certain sections of the New York insurance law expressly state that they are applicable only to New York domestic insurers, instances exist where foreign authorized insurers (and U.S. branches of alien insurers domiciled in states other than New York) must "substantially comply" with the requirements and limitations of such sections.

This substantial compliance requirement is set forth in Insurance Law Section 1106(e). In essence, it provides that the application of requirements and limitations in the insurance law, which by their terms are limited to domestic insurers, nonetheless may also apply to foreign authorized insurers (and U.S. branches of alien insurers) if the New York Superintendent of Financial Services determines that substantial compliance with such requirements or limitations is "reasonably necessary to protect the interests of the people of New York."

One application of New York's substantial compliance rule is described in an Oct. 4, 2000, Office of General Counsel opinion of the then-New York Insurance Department, now known as the Department of Financial Services. In that opinion, the OGC reviewed the potential applicability of Insurance Law Section 1207 to foreign insurers that are licensed in New York. Section 1207 prohibits "a domestic stock insurance company" from distributing options on its authorized but unissued stock to anyone other than its own officers and employees.

Although the provisions of section 1207 are limited only to New

York domestic stock insurers, the OGC concluded that, based on the section 1106(e) substantial compliance rule, a New York licensed foreign insurer is prohibited from paying bonuses in the form of stock options to compensate agents and brokers who are not officers or employees of the foreign insurer.

Foreign and alien insurers seeking to become licensed in New York should be aware that, in certain circumstances, they may be subject to New York statutory requirements that would seemingly apply only to New York domestic insurers.

2. The 'Appleton Rule'

New York's "Appleton Rule," which derives its name from former New York Deputy Superintendent Henry D. Appleton, requires foreign insurers and U.S. branches of alien insurers licensed in New York to adhere to certain requirements and limitations of the insurance law with respect to their operations outside of New York. Specifically, section 1106(f) prohibits foreign insurers and U.S. branches of alien insurers from transacting outside of New York any kind or combination of kinds of insurance business not permitted to be done in New York by similar domestic insurers, unless in the judgment of the superintendent such kind or combination of kinds of insurance business will not be prejudicial to the best interests of the people of New York.

For example, because New York allows financial guaranty insurance policies to be issued in New York only by monoline financial guaranty insurers, a foreign insurer (or U.S. branch of an alien insurer) licensed in New York (but not licensed as a monoline financial guaranty insurer) is prohibited from issuing financial guaranty insurance policies in New York. The Appleton Rule serves to prohibit these insurers from issuing financial guaranty insurance policies in any other jurisdiction, even if authorized to issue such policies

under another state's law.

Foreign and alien insurers seeking to become licensed in New York should be aware that, unless they receive an exception from the superintendent, they will, upon becoming licensed in New York, be prohibited from transacting outside of New York the kinds of insurance that may not be transacted in New York by domestic insurers, even if the insurer would be permitted to transact such insurance under the laws of the states in which the activities take place.

3. New York's Selling Expense Limits

Insurance Law Section 4228 limits the selling expenses, including agent and broker commissions, that may be paid or reimbursed by domestic, foreign and alien life insurance companies that are doing an insurance business in New York and engaged in the direct sale of individual life insurance policies and individual annuity contracts. The limitations do not apply to the sale of such policies and contracts to the extent that they are issued for delivery outside the U.S. and its possessions.

Because the purpose of section 4228 is to protect the financial integrity of life insurers doing business in New York, the expense limitations apply to both in-state and out-of-state U.S. sales of individual life insurance policies and annuity contracts. In a Sept. 22, 2006, opinion, the OGC explained that if this were not the case, "excessive expenses for out-of-state sales of individual life insurance policies or individual annuity contracts of an insurer could threaten the financial integrity of the entire company, thereby adversely affecting New York consumers."

As the section 4228 expense limitations apply to all of a New York licensed insurer's individual life and annuity sales that take place in the U.S. and its possessions, to the extent that the insurer's domiciliary

state would permit such an insurer's expense limitations to exceed the New York limitations, a foreign or alien insurer would still be required to comply with New York's expense limitations, even with respect to its out-of-state sales.

To avoid the application of section 4228 to individual life insurance and annuity sales outside New York, rather than becoming licensed in New York, foreign and alien life insurers should consider forming a separate affiliated New York domestic life insurer that would be licensed only in New York. By forming a life insurer licensed only in New York, the total selling expenses of the group's non-New York life insurance business would be insulated from the application of section 4228.

Due to the application of section 4228's expense limitations, many insurance groups limit New York life insurance sales to a New York-only licensed insurer.

4. Exceptions to Insurer Licensing

Compared to many other U.S. states, New York's exceptions to insurer licensing are somewhat limited. Foreign and alien insurers that are not licensed in New York should be aware of the following limitations concerning New York's insurer licensing exceptions:

a. No Industrial Insured Exception to Insurer Licensing. Many U.S. states allow unauthorized insurers to sell within the state certain kinds of insurance to "industrial insureds." The industrial insured exception permits unauthorized insurers to sell insurance to large companies that generally have a specified number of employees; use a risk manager or broker to purchase their insurance; and pay at least \$25,000 to \$50,000 per year for all of their insurance coverage. New York does not have an industrial insured exception to insurer licensing.

b. Limited Reinsurance Exception to Insurer Licensing. In most U.S. states, transacting reinsurance is explicitly exempted from the definition of transacting insurance (or from the related licensing requirement). In such U.S. states, a reinsurer generally need not be licensed to directly solicit, negotiate and/or effectuate contracts of reinsurance.

Unlike most U.S. states, doing a reinsurance business is explicitly included in New York's definition of doing an insurance business. As a result, in New York an insurer generally may not transact reinsurance without first obtaining a New York insurance license (or becoming a New York accredited reinsurer). However, in New York, an unlicensed insurer may "indirectly" transact reinsurance through the use of properly licensed reinsurance intermediaries, as permitted by section 2117(d), and may also transact reinsurance "by mail" from outside of New York, as permitted by section 1101(b)(2)(G).

However, an unauthorized/unaccredited insurer/reinsurer could not directly (without an intermediary) meet in New York with a New York licensed insurer to effectuate a reinsurance transaction.

c. Limited "Post Sale" Licensing Exception

Many states' laws provide for an insurer licensing exception with respect to policies that have previously been solicited, negotiated, issued and delivered outside of the state and where the risk insured was not located in the state at the time of policy issuance. Although New York has a similar post-sale licensing exception (known in New York as the "mail order" exception), this exception is limited by the fact that such post-sale activities only may be effected "by mail" including by e-mail. The OGC has interpreted this limitation as follows: The mail order exception is just that: an exception for mail. The exception does not apply to other kinds of contact from outside

the state, such as by telephone. It also obviously does not apply to any activity physically occurring within the state of New York.

5. New York's Prohibition Against Calling Attention to Unauthorized Insurers

In addition to New York's prohibitions against doing an insurance business without a license (and aiding an unauthorized insurer), unauthorized foreign and alien insurers and those acting on their behalf in New York should also be aware of Insurance law section 2122(a)(2). It prohibits calling attention to unauthorized insurers and provides that "[n]o insurance agent, insurance broker or other person shall, by any advertisement or public announcement in [New York], call attention to any unauthorized insurer or insurers."

The terms "advertisement" and "public announcement" are not defined in the insurance law. However, the OGC has opined that an analysis of whether a document constitutes an "advertisement" depends upon "whether [the ad is] designed to be used or [is] actually used, to induce the public to purchase, increase, modify, reinstate or retain a policy."

Additionally, the OGC has opined: "Placing the unauthorized insurer's name into the stream of commerce such as in directories, displaying it on an outside door, or on stationery, including business cards, are all considered by the department to be a public announcement that would attract notice."

Unauthorized insurers and those acting on their behalf should be careful not to call attention to unauthorized insurers in New York. Indeed, pursuant to the OGC's interpretation, merely distributing business cards in New York that contain the name of an unauthorized insurer could constitute a violation of the insurance law. BR