

# The “Modernization” of Reinsurance Regulation: The Dodd-Frank Act and Beyond

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# Presenters

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# Overview

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- Basics of the Dodd-Frank Act (“DFA”) as it may relate to reinsurers and reinsurance
- Context of the DFA, including other regulatory initiatives
- Potential impact of DFA on regulation of reinsurance and conduct of business of reinsurance

# DFA Basics

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- Relatively few sections directly addressing reinsurance issues
- Substantially preserves the state-based insurance regulation scheme
- Holds potential for future regulation
- Potential impact of systemic regulation and liquidation provisions

# Sources of Proposals and Issues

- National Association of Insurance Commissioners (“NAIC”)
  - Regulation of specific issues, such as collateral requirements
  - Proposed comprehensive reinsurance regulation – Reinsurance Regulatory Modernization Act of 2009 (“RRMA”) – federal legislation without a sponsor
- Individual states
  - Collateral requirements – NY and FL
  - Reinsurance contracting and other requirements
- US Government – Dodd-Frank Act
  - Financial turmoil – insurance not perceived as major contributor
- Related issues
  - Controversy regarding different requirements for non-US domiciled companies

# How did we get here: the NAIC approach

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- Originally prompted by concerns over reinsurance collateral requirements
  - Status quo: generally requires non-US (unauthorized) reinsurers to post collateral
  - Foreign reinsurers argue collateral requirement is unfairly discriminatory
  - Some states acted to modify collateral requirements (NY and FL)
  - Morphed into a single “framework” (“National Reinsurers” and “Port-of-Entry Reinsurers”) with ratings-based collateral requirements
- Proposed federal legislation to implement framework – the *Reinsurance Regulatory Modernization Act of 2009 (“RRMA”)*

# NAIC – what happened?

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- Apparently unable to find Congressional sponsorship for RRMA
- Shifted efforts to lobby for preservation of state-based insurance regulation
- Largely successful (so far)

# How did we get here: individual states

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- Some states act to modify collateral requirements for reinsurance
  - New York
  - Florida

# How did we get here: US Congress

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- Nonadmitted and Reinsurance Reform Act – reinsurance credit and solvency regulation
  - introduced over 4 or more years
  - Sometimes passed House; never passed Senate
  - Swept into omnibus Dodd-Frank Act
- DFA financial regulation “modernization” takes a different approach – extensive regulation of other industries, but more limited regulation and “studies” of insurance and reinsurance
- DFA expressly rejects any federal “general supervisory or regulatory authority over the business of insurance”

# Dodd-Frank Act components

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- Federal Insurance Office (“FIO”)
  - No Federal Insurance Regulator
  - No optional federal insurance charter
- Consumer Financial Protection Agency (excludes insurance)
- Systemic Risk regulation
- Resolution authority
- Federal control over international insurance agreements
- Limited preemption of state insurance regulation
- Nonadmitted and Reinsurance Reform Act
- DFA not cover health insurance, long-term care insurance (unless part of life insurance or annuity) and federal crop insurance
- Studies of insurance and reinsurance markets
- Widespread recognition that recent economic problems not caused by insurance sector (including reinsurance) and that it has weathered the economic storms relatively well – a low priority sector of the economy for regulatory reforms

# Federal Insurance Office - summary

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- Office within Treasury
- Largely study and monitor
- Substantial authority for international insurance agreements
- May determine that international agreement preempts state laws
- Role in implementing other portions of DFA

# Federal Insurance Office – what it is

- **monitor all aspects of the insurance industry, including identifying issues or gaps in the regulation of insurers that could contribute to a systemic crisis in the insurance industry or the United States financial system;**
- monitor the extent to which traditionally underserved communities and consumers, minorities, and low and moderate-income persons have access to affordable insurance products (for all insurance lines except health insurance);
- recommend to the Financial Stability Oversight Council (“Council”) when it should designate an insurer, including its affiliates, as an entity subject to regulation as a nonbank financial company subject to enhanced prudential regulation by the Fed;
- assist the Secretary in administering the terrorism insurance program under the Terrorism Risk Insurance Act of 2002;
- coordinate federal efforts and establish 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 in negotiating international agreements regarding prudential measures with respect to the business of insurance or reinsurance;
- determine whether state insurance measures are preempted by such international agreements; and
- consult with the states regarding insurance matters of national importance and prudential insurance matters of international importance

# DFA does NOT

- **preempt any state insurance measures that govern an insurer's rates, premiums, underwriting or sales practices;**
- preempt any state coverage requirements for insurance;
- preempt the application of the antitrust laws of any state to the business of insurance;
- **preempt any state insurance measure governing the capital or solvency of an insurer, except to the extent that such measure results in less favorable treatment of a non-United States insurer than a United States insurer** (although later provisions of the DFA outside the FIO provisions, such as those described below dealing with credit for reinsurance, would have an impact on capital and potentially the solvency of ceding insurers);
- limit the authority of the United States Trade Representative;
- affect the preemption of state insurance measures preempted by other federal law;
- **establish or provide the FIO or the Department of the Treasury with general supervisory or regulatory authority over the business of insurance;** or
- limit the authority of any federal financial regulatory agency

# Financial Stability Oversight Council – what is it?

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- Interdepartmental group with role in determining if and when a company presents such risks to the US economy that it should be heavily regulated by the Fed or liquidated
- May apply to insurance or reinsurance companies
- State insurance regulators have advisory role

# Financial Stability Oversight Council - functions

- collecting information necessary for assessing risks to United States financial system; Council could obtain such information from federal and state agencies and regulators and, through the Office of Financial Research, from bank holding companies and nonbank financial companies;
- monitoring financial services marketplace to identify potential threats to financial stability of United States;
- providing direction to and requesting data and analyses from Office of Financial Research;
- monitoring domestic and international financial regulatory proposals and developments, including insurance and accounting issues, and advising Congress and making recommendations in such areas that will enhance integrity, efficiency, competitiveness, and stability of United States financial markets;
- facilitating information sharing and coordination among federal and state agencies regarding domestic financial services policy development, rulemaking, examinations, reporting requirements, and enforcement actions;
- recommending to member agencies general supervisory priorities and principles;
- identifying regulatory gaps that could pose risks to financial stability of United States;
- requiring supervision by Fed of nonbank financial companies that may pose risks to financial stability of United States in event of their material financial distress or failure;
- making recommendations to Fed concerning establishment of prudential standards for risk-based capital, leverage, liquidity, contingent capital, resolution plans, credit exposure reports, concentration limits, enhanced public disclosures, and overall risk management for companies supervised by Fed;
- identifying systemically important financial market utilities and payment, clearing and settlement activities;
- making recommendations to various primary financial regulatory agencies (defined to include both federal and state agencies) to apply new or heightened standards and safeguards for financial activities or practices that could create or increase risks of significant liquidity, credit, or other problems spreading among bank holding companies, nonbank financial companies, and United States financial markets;
- reviewing and submitting comments to SEC and any standard-setting body with respect to any existing or proposed accounting principle, standard, or procedure;
- providing a forum for discussion of emerging market developments and financial regulatory issues and resolution of jurisdictional disputes among members of Council; and
- reporting annually to and testifying before Congress on:
  - activities of Council;
  - significant financial market and regulatory developments, including insurance and accounting regulations and standards, with an assessment of those developments on stability of financial system;
  - potential emerging threats to financial stability of United States;
  - determinations by Council that companies should be subject to enhanced prudential regulation;
  - resolution by Council of jurisdictional disputes among agencies; and
  - Council's recommendations to enhance integrity, efficiency, competitiveness, and stability of United States financial markets, to promote market discipline, and to maintain investor confidence

# Systemic Risk regulation

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- Enhanced prudential regulation of companies deemed a threat to national economy
- Mainly directed at depository institutions, but includes nonbank financial companies (may include insurance or reinsurance companies)
- Determination by Council – regulation by the Fed
- Scope of regulation extraordinary – transform company
- For insurance companies – must consult with insurance regulators before determination is made
- Fed apparently the regulator
- Fed safe harbor regulation provision

# Systemic regulation criteria

- extent of leverage;
- extent and nature of off-balance-sheet exposures;
- extent and nature of transactions and relationships with other significant nonbank financial companies and significant bank holding companies;
- importance of company as a source of credit for households, businesses, and state and local governments and as a source of liquidity for United States financial system;
- importance of company as a source of credit for low-income, minority, or underserved communities, and impact that failure of company would have on availability of credit in such communities;
- extent to which assets are managed rather than owned, and extent to which ownership of assets under management is diffuse;
- nature, scope, size, scale, concentration, interconnectedness, and mix of activities of company;
- **degree to which company is already regulated by one or more primary financial regulatory agencies (defined to include state insurance regulators and SEC);**
- amount and nature of financial assets of company;
- amount and types of liabilities, including degree of reliance on short-term funding; and
- any other risk-related factors that Council deems appropriate

# Resolution authority (liquidation)

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- Goal: avoid disorderly failure of companies, if such failure would have serious adverse effects on financial system or economy (“too big to fail” and somewhat smaller companies)
- Secretary decides – recommendation by Fed and FDIC – for insurance companies, from Fed and FIO Director
- Liquidation of insurance companies through existing state-based insolvency structure

# International agreements relating to reinsurance

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- Secretary of the Treasury and U.S. Trade Representative may negotiate and enter into international insurance agreements on prudential matters, after consulting with Congress
- FIO shall represent United States in discussions with International Association of Insurance Supervisors (NAIC formerly had such discussions)

# Preemption determinations

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- FIO's Director may determine, after consultations and period for written comments, that a state insurance measure is preempted by federal law if the state measure: (1) treats a non-U.S. domiciled insurer that is subject to an international agreement on prudential measures less favorably than it treats a U.S.-domiciled insurer; and (2) is inconsistent with such an international agreement
- FIO must report annually to Congress regarding any preemption determinations

# Nonadmitted and Reinsurance Reform Act – a very limited agenda

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- Reinsurance credit – generally prohibits state from denying credit for reinsurance if state of domicile of ceding insurer recognizes credit
- Solvency regulation – in general, reinsurer's domicile state solely responsible for regulating reinsurer's financial solvency
- Financial information – prohibits state from requiring reinsurer to provide financial information other than that required to be filed with its NAIC-compliance domiciliary state
- Effective July 21, 2011

# DFA reinsurance provisions

- If state of domicile of ceding insurer recognizes credit for reinsurance for insurer's ceded risk, no other state may deny such credit for reinsurance, so long as state of domicile is NAIC-accredited or has financial solvency requirements similar to NAIC accreditation requirements;
- Except for laws with respect to taxes and assessments on insurance companies and insurance income, preempt the extraterritorial application of the law of a state to a ceding insurer not domiciled in that state to the extent that such laws:
  - restrict or eliminate the rights of the ceding insurer or the assuming insurer to resolve disputes pursuant to contractual arbitration consistent with the provisions of Title 9 of the United States Code;
  - require that a certain state's law shall govern the reinsurance contract, disputes arising from the reinsurance contract, or requirements of the reinsurance contract;
  - attempt to enforce a reinsurance contract on terms different than those set forth in the reinsurance contract, to the extent that the terms are not inconsistent with this portion of DFA; or
  - otherwise apply the laws of the state to reinsurance agreements of ceding insurers not domiciled in that state;
- If state of domicile of a reinsurer is NAIC accredited, or has financial solvency requirements substantially similar to those required for NAIC accreditation, that state shall be solely responsible for regulating its financial solvency, and no other state may require the reinsurer to provide any additional financial information other than what the reinsurer is required to file with its domiciliary state

# DFA Nonadmitted Insurance – principal provisions

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- establish a “home state” for insureds for purposes of this portion of the DFA, namely the state in which the insured maintains its principal place of business; except that, if 100% of the insured risk is located in other states, the home state shall be the state to which the greatest percentage of the insured’s taxable premium is allocated;
- premium taxes:
  - provide that no state other than home state of an insured may require payment of any premium tax for nonadmitted insurance;
  - provide that states may enter into a compact or other procedures for the allocation of nonadmitted premium tax revenues among the states;
  - require that NAIC submit a report to Congress identifying and describing any such interstate compact or other procedures for allocating premium taxes among the states; and
  - encourage the adoption by each state of nationwide uniform requirements, forms, and procedures for reporting, payment, collection, and allocation of such taxes;

# DFA Nonadmitted Insurance – other provisions

- provide that placement of nonadmitted insurance shall be subject to regulation solely by the insured's home state;
- after a two-year exemption period, prohibit the collection by states of fees relating to the licensing of an individual or entity as a surplus lines broker unless state participates in a national insurance producer database (whether under the sponsorship of the NAIC or otherwise);
- prohibit a state from establishing eligibility requirements for United States-domiciled nonadmitted insurers that vary from the provisions of NAIC's Non-Admitted Insurance Model Act;
- Prohibit a state from prohibiting a surplus lines broker from placing nonadmitted insurance with, or procuring nonadmitted insurance from, a nonadmitted non-United States domiciled insurer that is listed on Quarterly Listing of Alien Insurers maintained by International Insurers Department of NAIC;
- restrict ability of states to require surplus lines brokers seeking to procure or place nonadmitted insurance for an exempt commercial purchaser (a term subject to a multi-part definition) to make a due diligence search to determine whether the full amount or type of insurance sought by such exempt commercial purchaser can be obtained from admitted insurers, under specified circumstances

# Required study regarding reinsurance

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- A report by the FIO to certain Congressional committees no later than September 30, 2012 describing breadth and scope of the global reinsurance market and critical role that such market plays in supporting insurance in United States
- Although purpose of this study is not specified, many studies of this type provided for in the DFA appear to be designed to provide facts and recommendations to Congress for consideration of further regulation of subject matter of study

# Required studies – by FIO

- A report to certain Congressional committees no later than January 1, 2013 (and updated not later than January 1, 2015), describing impact of Part II of Nonadmitted and Reinsurance Reform Act of 2010 (see subpart D below) on ability of state regulators to access reinsurance information for regulated companies in their jurisdictions;
- A report resulting from a special one-time study on how to modernize and improve system of insurance regulation in United States. This report would contain any appropriate legislative and regulatory recommendations, and would be provided to Congress not later than 18 months after enactment of DFA. In conducting study, FIO would be required to consult with NAIC, consumer organizations, representatives of insurance industry, and policyholders. In this connection, FIO would be required to consider following factors:
  - systemic risk regulation;
  - capital standards;
  - consumer protection for insurance products and practices;
  - degree of national uniformity of state insurance regulation;
  - regulation of insurance companies and affiliates on a consolidated basis;
  - international coordination of insurance regulation;
  - costs and benefits of potential federal regulation across various lines of insurance (except health insurance);
  - feasibility of regulating only certain lines of insurance at the federal level;
  - ability of any potential federal regulation or regulator to eliminate or minimize regulatory arbitrage;
  - impact that developments in regulation of insurance in foreign jurisdictions might have on potential federal regulation of insurance;
  - ability of any potential federal regulation or regulator to provide robust consumer protection for policyholders; and
  - potential impact of subjecting insurance companies to a federal resolution authority on (i) operation of state insurance guaranty funds, (ii) policyholder protection, (iii) separate account issues, and (iv) international competitiveness

# Required studies – by GAO

- A study of nonadmitted insurance market, in consultation with the NAIC, covering:
  - change in the size and market share of nonadmitted insurance market and in number of insurance companies and insurance holding companies providing such business over an 18 month period of time;
  - extent to which insurance coverage typically provided by admitted insurance market has shifted to the nonadmitted insurance market;
  - consequences of any change in size and market share of nonadmitted insurance market, including differences in price and availability of coverage available in both admitted and nonadmitted insurance markets;
  - extent to which insurance companies and insurance holding companies that provide both admitted and nonadmitted insurance have experienced shifts in volume of business between admitted and nonadmitted markets; and
  - extent to which there has been a change in number of individuals who have nonadmitted insurance policies, type of coverage provided under such policies, and whether such coverage is available in admitted insurance market.

# Practical impact?

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- Applicable law – how changed?
- Collateral for reinsurance
- Extraterritorial reach of state requirements
- Reinsurance contracting
- Reinsurance regulation at NAIC level
- Impact on state regulation
- International business

# Conclusion

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- Federal legislative phase appears to be completed for now
- Focus now shifts to hundreds of new regulations required by the DFA
- Not possible to predict the direction things may take for reinsurance industry
- Federal studies and further NAIC action possible (e.g., retooling the RRMA)
- State reaction unknown

# For further information

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- Some of the bills, reports, and underlying documents are available in the subscriber only area of [www.ReinsuranceFocus.com](http://www.ReinsuranceFocus.com)
- Jordan Burt is providing more detailed advice and presentations to its clients
- Contact
  - Roland Goss at [rcg@jordenusa.com](mailto:rcg@jordenusa.com) or (202) 965-8148
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