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Hot Topics in Insurance Regulation

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Presented by: David Alberts, Joshua Cohn, Lawrence Hamilton, Charles Horn, Martin Mankabady and Kenneth Pierce

Welcome

Mayer Brown's Insurance Industry Group

- Mayer Brown has established an Insurance Industry Group, with over 100 lawyers who have specific insurance and reinsurance transactional, regulatory and dispute resolution experience. We have advised on:
  - Over 50 major recent corporate finance and M&A transactions in the insurance sector totaling billions of dollars.
  - Dozens of sidecars and complex reinsurance transactions at the convergence of insurance and capital markets.
  - Hundreds of insurance and reinsurance claim and dispute resolution matters involving property, casualty, life and annuity products, including some of the industry's highest profile and highest stakes arbitrations and litigations.
- The Group's mission is to deliver comprehensive inter-disciplinary insurance and reinsurance expertise through a seamless team-oriented approach that draws upon Mayer Brown's enormous depth in all related areas of the law.
- In order to better serve clients in all global markets, Mayer Brown focuses its practice exclusively on the representation of insurers, reinsurers, intermediaries, banks and investors.

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Program Overview

- Holding Company and Capital Issues: Federal, State and the European Union
- Regulation of Activities of the Insurance Industry after the Dodd-Frank Act
- Economic Implications for the Insurance Industry Arising from Financial Reform

Holding Company and Capital Issues: Federal, State and the European Union

Presented by: David Alberts, Lawrence Hamilton, Charles Horn and Martin Mankabady

Holding Company and Capital Issues: Federal, State and the European Union

- Systemic Risk Regulation, Group Supervision and Holding Company Law Changes
- NAIC Solvency Modernization Initiative and Proposed Revisions to Insurance Holding Company Regulation
- Solvency II
- Cross-Border Equivalence and Recognition

Systemic Risk Regulation, Group Supervision and Holding Company Law Changes

Systemically Significant Companies

- The Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) was signed into law on July 21, 2010
- Addresses systemic risks posed by large financial firms by imposing enhanced supervision and prudential standards
- Creates federal resolution authority for unwinding certain systemically risky companies
- Creates a new consumer protection agency
- Imposes registration and reporting requirements for hedge funds and private equity investors

Systemically Significant Companies

- Increases investor protections
- Regulates over-the-counter derivatives
- Creates the Federal Insurance Office

Systemically Significant Companies

- Title I of Dodd-Frank subjects systemically significant companies to enhanced supervision.
  - Bank holding companies with assets equal to or greater than $50 billion
  - Nonbank financial as determined by the Financial Stability Oversight Council (“FSOC”)

Systemically Significant Companies

- General standard for nonbank financial company designation:
  - “Material financial distress” at the nonbank financial company, <u>or</u> the “nature, scope, size, scale, concentration, interconnectedness or mix “ of the company’s activities, “could pose” a threat to US financial stability.
  - Numerous considerations may be taken into account by the FSOC.

Systemically Significant Companies

- Insurance companies as SSCs
  - Title I standards should not routinely cover typical insurance company underwriting activities.
  - Main systemic risk concerns would be with affiliates (e.g., broker-dealers, derivatives dealers, banks) and very large insurers.
  - Insurers with bank affiliates <u>and</u> assets equal to or over $50 billion <u>will</u> be designated as SSCs.

Systemically Significant Companies

- Foreign insurance companies as SSCs
  - SSC designation criteria focus on US activities of the foreign company, but otherwise are generally the same.
  - A designated foreign company may place all "financial" activities in an intermediate holding company for regulatory supervision purposes.
  - Federal Reserve Board may not supervise nonfinancial activities of the foreign company.

Systemically Significant Companies

- What are the consequences of SSC designation?
  - Subject to regulation, supervision and examination by the Federal Reserve Board (FRB)
  - Enhanced prudential standards for capital, liquidity, living wills, risk management and many more
  - Stress testing, early remediation for companies in financial distress

Systemically Significant Companies

- FRB enhanced prudential authority
  - FRB may, upon recommendation of FSOC <u>or on its own initiative</u>, subject nonbank financial companies and bank holding companies with assets equal to or over $50 BB, to enhanced supervision.
  - Standards for foreign companies must give due regard to principles of national treatment and competitive equality, and take into account nature and quality of home country supervision in relation to US standards.

The Resolution Scheme for SSCs

- Title II of Dodd-Frank sets forth an orderly resolutions scheme for SSCs
- SSCs will be resolved by the FDIC outside of the US Bankruptcy Code
- The statutory resolutions scheme requires <u>liquidation</u> – <u>reorganization</u> is not an option

The Resolution Scheme for SSCs

- Process is set in motion by joint determination of the FRB and the FDIC with or without Treasury request.
- Funding
  - Paid for by a new Orderly Liquidation Fund that is funded by FDIC-risk based assessments on SSCs.
  - Taxpayers are to bear no financial responsibility for losses.

The Resolution Scheme for SSCs

- Procedures for FDIC resolutions of SSCs generally mirror those currently used by the FDIC for failed bank resolutions.
  - Creditors of SSCs in resolution do not get automatic stay and a number of other customary Bankruptcy Code rights.
- New resolutions scheme does <u>not</u> extend to foreign financial companies, but could cover US subsidiaries of such companies.

The Resolution Scheme for SSCs

- Treatment of insurance companies under the SSC resolutions authority
  - Resolutions determination must be made by 2/3 vote of the FRB and the Director of the Federal Insurance Office, in consultation with the FDIC.
  - Resolutions process for insurance companies is governed by state (insurance) law.

NAIC Solvency Modernization Initiative and Proposed Revisions To Insurance Holding Company Regulation

NAIC Solvency Modernization Initiative

The NAIC Solvency Modernization Initiative is a critical self-examination process aimed at updating the US insurance solvency regulation framework and at least considering international models. It focuses on five key issues:

- Capital requirements
- Governance and risk management
- Group supervision
- Statutory accounting and financial reporting
- Reinsurance

Capital Requirements

- Focus is on improving the risk-based capital (“RBC”) formulas, factors and methodology
- Goal is to have determined changes to RBC by December 2012

Governance and Risk Management

- Study international corporate governance principles and standards
- Outline high-level governance principles by December 2011
- Develop Enterprise Risk Management (“ERM”)/Own Risk and Solvency Assessment (“ORSA”) tool
- Develop model law or other implementation tool by December 2012

Statutory Accounting and Financial Reporting

- Implement principles-based reserving for life insurance reserves by summer 2011
- Current statutory accounting system includes automatic consideration of any new GAAP pronouncements (each is adopted, modified or rejected)
- New mandate: evaluate inclusion/exclusion of IFRS from the framework of insurance solvency regulation
- Also evaluate regulatory impact of non-regulatory use of statutory financial statements

Reinsurance

- At its winter 2008 national meeting, the NAIC adopted a Reinsurance Regulatory Modernization Framework (“RRMF”), which would apply a ratings-based sliding scale to determine collateral requirements for nonadmitted reinsurers, rather than requiring 100% collateralization as is currently the case in most states
- The NAIC recognized that RRMF would require federal implementing legislation, so the NAIC subsequently approved draft legislation called the Reinsurance Regulatory Modernization Act of 2009
- While the NAIC has been unable to procure congressional sponsorship for its proposed legislation, the inclusion of the Nonadmitted and Reinsurance Reform Act (“NARRA”) in Dodd-Frank has cleared the way for individual states to adopt the RRMF for the benefit of ceding companies domiciled in their states
- Under NARRA, non-domiciliary states are prohibited from denying credit for reinsurance if the cedent’s domiciliary state recognizes the credit and is either NAIC-accredited or has substantial similar financial solvency requirements

Group Supervision

- Group supervision is performed under each state’s Insurance Holding Company Act and Regulations, most of which are based on NAIC models that were first adopted in 1969 and last amended in 2001
- The existing holding company regulatory regime is focused on building “walls” around the insurer:
  - Domestic commissioner’s approval required to acquire control of an insurer (Form A)
  - Domestic commissioner gets to review insurer’s material transactions with affiliates and extraordinary dividends (Form D)
  - Domestic commissioner has power to examine insurers and, where insurer fails to produce information, the insurer’s affiliates
  - Domestic commissioner has exclusive receivership authority over insolvent insurers

Group Supervision

- The NAIC plans to move from an approach based on “walls” to an approach based on “windows and walls”
- The term “windows” means being able to look at any entity within an insurance holding company system that could pose financial or reputational risk to the insurer
  - More communication between regulators and participation in “supervisory colleges”
  - Development of holding company “best practices”
  - Access to more financial information about the insurer’s parent and other affiliates
  - Consideration of group-wide capital assessment
- The NAIC is preparing to adopt, at its October 2010 meeting, revisions to the NAIC Insurance Holding Company Model Act and Regulations – those revisions need to be enacted by state legislatures in order to become effective

Proposed Revisions to the "Form B" Annual Holding Company Registration Statement

- Form B must be filed with the NAIC as well as the domiciliary state commissioner
- Must include a statement that the insurer's board of directors is responsible for and oversees corporate governance and internal controls and that the insurer's officers or senior management have approved, implemented and continue to maintain and monitor corporate governance and internal control procedures
- Must include a confidential ERM report provided by the insurer's ultimate controlling person, designed to identify the material risks within the insurance holding company system that could pose financial and/or reputational contagion to the insurer

Items to Be Covered in the ERM Report

- Any material developments regarding strategy, internal audit findings, compliance or risk management affecting the insurance holding company system
- Acquisition or disposal of insurance entities and reallocating of existing financial or insurance entities within the insurance holding company system
- Any changes of shareholders of the insurance holding company system exceeding 10% of voting securities
- Developments in various investigations, regulatory activities or litigation that may have a significant bearing or impact on the insurance holding company system
- Business plan of the insurance holding company system and summarized strategies for next 12 months

Items to Be Covered in the ERM Report

- Identification of material concerns of the insurance holding company system raised by supervisory college, if any, in last year
- Identification of insurance holding company system capital resources and material distribution patterns
- Identification of any negative movement, or discussions with rating agencies which may have caused, or may cause, potential negative movement in the credit ratings and individual insurer financial strength ratings assessment of the insurance holding company system (including both the rating score and outlook)
- Information on corporate or parental guarantees throughout the holding company and the expected source of liquidity should such guarantees be called upon
- Identification of any material activity or development of the insurance holding company system that, in the opinion of senior management, could adversely affect the insurance holding company system

Proposed Revisions to the "Form A" Acquisition Process

- Acquiring person required to acknowledge that it and all subsidiaries within its control will provide information to the commissioner upon request as necessary to evaluate risk of financial and/or reputational contagion to the insurer
- Acquiring person must provide the ERM Report in an updated Form B within 15 days after end of month in which acquisition occurs
- Biographical affidavits for directors and executive officers must undergo a third-party background check
- Acquiring person must file a "Form E" in the domestic state to address competitive impact of the acquisition
- States may hold a joint public hearing if the Form A will require the approval of more than one commissioner
- A control person that wishes to divest its controlling interest in a domestic insurer must give the commissioner 30 days' prior notice

Proposed Revisions to the "Disclaimer of Control" Process

- Control is presumed when a person directly or indirectly holds 10% or more of voting securities
- Until now, the presumption could be rebutted by filing a disclaimer of control, which became effective immediately unless disallowed by the commissioner after a hearing
- Under the new proposal, disclaimers will no longer be automatically effective upon filing
- Disclaimers will only become effective if not disallowed within 30 days after filing
- If disallowed, applicant may request an administrative hearing to seek reconsideration of the commissioner's decision

Proposed Revisions to the “Form D” Affiliated Transaction Review Process

- Management service and cost sharing agreements must include 13 specific items
- Insurers need to file amendments or modifications to previously filed agreements, explaining the reason for the change and the financial impact on the insurer
- Need to notify the commissioner within 30 days of termination of a previously filed agreement
- All reinsurance pooling agreements must be filed; also need to look ahead three years when deciding if other reinsurance agreements meet the “5% of surplus” threshold for filing
- Must state how each inter-affiliate transaction meets the “fair and reasonable” standard
- Whenever charges are based on market rates instead of cost, need to supply the rationale

Proposed Enhancements to the Commissioner's Examination Powers

- Commissioner can examine not only the insurer but also its affiliates to ascertain the financial condition of the insurer, including the risk of financial contagion to the insurer by the ultimate controlling person, any affiliates or combination of affiliates, or the insurance holding company system on a consolidated basis
- Commissioner will have the power to issue subpoenas and examine persons under oath, and may seek a court order to enforce subpoenas, under penalty of contempt
- Sanctions for violating "Form A" approval requirements include prohibiting all dividends or distributions from the insurer and placing the insurer under regulatory supervision

Supervisory Colleges

- In order to assess the business strategy, financial position, legal and regulatory position, risk exposure, risk management and governance processes, and as part of the examination of domestic insurers with international operations, the commissioner may participate in a "supervisory college" with other regulators charged with supervision of the insurer or its affiliates, including other state, federal and international regulatory agencies

Solvency II

Solvency II: Overview

- Objectives
- Solvency II – Applies to?
  - Applies to life and non-life
  - Direct application to EU insurers
  - Indirect to non-EU with respect to groups and reinsurance
- Three pillars
  - EU-wide capital requirements
  - Risk management
  - Reporting standards

Solvency II: Overview

- Timetable
  - EU Directive
  - CEIOPS QI studies
  - implementation
- First wave of equivalence assessments
  - US?

Solvency II: Balance sheet

- Valuation of assets/liabilities
- Own funds
  - Tiers 1, 2 and 3
  - On/off-balance sheet
- Solvency capital requirement
- Minimum capital requirement
- Group supervision

Practical implications

- Raising new capital
- Business model
  - Underwriting discipline/pricing
  - Reinsurance
  - Securitisation
- Corporate activity
  - Restructuring
  - Mergers and acquisitions
- Increased costs
  - Enhanced governance structure

Outlook

- Some winners/some losers
- More strategic business planning
- Solvency II – Business Implications
  - Insurers overly-exposed to certain lines of business will likely need to rebalance their portfolios or take a capital hit. Expect rebalancing through:
    - Acquisitions
    - Dispositions
    - Reinsurance
    - Alternatives – e.g., longevity swaps
- Better articulation of risk appetite
- Encourage more efficient capital use
- Emerge as new international standard?

Cross-Border Equivalence and Recognition

Cross-Border Equivalence and Recognition

- Solvency Modernization and Groups
  - Focus on Capital Adequacy at Group Level (Federal, State and EU)
  - Global Insurer/Reinsurer – How, if at all, applies to my group, my subs, my reinsurance deals?
    - Answer hinges on where your operations are and determination of "equivalence" of those jurisdictions or other harmonization (or lack thereof) efforts.

Cross-Border Equivalence and Recognition

- Cross-Border Equivalence and Recognition
  - – Three equivalence assessments under Solvency II
    - Reinsurance supervision (Article 172)
      - – i.e., reinsurance contract by EU entity with non-EU reinsurer (e.g., US, Canada, Bermuda)
    - Group solvency calculation (Article 227)
      - – Counting non-EU subs capital in EU parent/group
    - Third country group supervision (Article 260)
      - – Deference to non-EU parent supervisor for group supervision?
  - – Committee of European Insurance and Occupational Pensions Supervisors ("CEIOPS") issued its final advice on consideration for first wave equivalence assessments to the European Commission on August 31, 2010

Cross-Border Equivalence and Recognition

- Bermuda and Switzerland were recommended for inclusion in the first wave for all three equivalence assessments
- United States was recommended for inclusion in the first wave of assessments in respect of reinsurance supervision and group solvency calculation
- The European Commission is scheduled to decide whether to act on the recommendations of CEIOPS in October 2010

Cross-Border Equivalence and Recognition

- Group Supervision – Business Implications
  - Tension with heightened home state regulation
  - Increased knowledge of activities by companies required within groups; possible group reorganization
  - Impact on capital deployment, intra-group reinsurance, intra-group capital support and other intra-group transactions, entities, regulatory coordination and other management aspects
  - Impact on use of jurisdictions of ILS, swaps, transformer deals and other use of SPVs

Cross-Border Equivalence and Recognition

- Solvency II – Business Implications
  - Insurers overly-exposed to certain lines of business will likely need to rebalance their portfolios or take a capital hit. Expect rebalancing through:
    - Acquisitions
    - Dispositions
    - Reinsurance
    - Alternatives – e.g., longevity swaps

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Regulation of Activities of the Insurance Industry after the Dodd-Frank Act

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Regulation of Activities of the Insurance Industry after Dodd-Frank

- Derivatives
- Reinsurance
- Surplus Lines Regulation
- The Volcker Rule

Derivatives

Derivatives

- Title VII (the "Wall Street Transparency and Accountability Act of 2010") of Dodd-Frank addresses the derivatives market
- SEC and CFTC will share authority over derivatives
- Both agencies will prescribe regulations necessary to carry out Title VII
- Regulations shall be issued in final form not later than 360 days from the enactment of Dodd-Frank
- Swaps shall not be considered to be insurance and shall not be regulated as insurance contracts under any state laws

Derivatives

- Central clearing and exchange trading required for derivatives that can be cleared (regulator and clearinghouse will have roles in making determination)
- Exemption – any swap that would otherwise be subject to clearing will not be required to be cleared if one of the counterparties:
  - is not a financial entity,
  - uses swaps to hedge commercial risk, and notifies the regulator as to how it generally meets its financial obligations associated with non-cleared swaps

Derivatives

- Transitional Rules
  - Reporting – swaps entered into prior to enactment of the Act must be reported to a registered data repository or regulator not later than 180 days after date of enactment
  - Clearing – swaps entered into prior to enactment of Dodd-Frank or before the effective date of the clearing requirement are exempt from clearing if they are reported to a registered data repository or regulator
- "Swap Dealers", "Security-Based Swap Dealers", "Major Swap Participants" and "Major Security-Based Swap Participants" will be subject to Title VII

Derivatives

- “Major Swap Participant” includes, inter alia, any person who maintains a “substantial position” in swaps or whose outstanding swaps create a substantial counterparty exposure that could have serious adverse effects on the financial stability of the US banking system or financial markets
- “Substantial position” is not yet defined
- Exception – “Major Swap Participant” does not include an entity whose primary business is providing financing, and uses derivatives for the purpose of hedging underlying commercial risks related to interest rate and foreign currency exposures, 90% or more of which arise from financing that facilitates the purchase or lease of products, 90% or more of which are manufactured by the parent company or another subsidiary of the parent company

Derivatives

- Affected entities will be subject to, among other things, registration requirements, capital requirements, margin requirements, and reporting and recordkeeping requirements
- Title VII shall not apply to activities outside of US unless those activities:
  - have a direct and significant connection with activities in, or effect on, US commerce, or
  - contravene the rules and regulations necessary to prevent the evasion of Title VII
- CFTC and SEC have the power to label the regulation of swaps by a foreign country a danger to the stability of the US financial system

Derivatives

- An entity domiciled in such country would be prohibited from participating in any US swap activity
- US regulators shall consult and coordinate with foreign regulators to promote international harmonization of OTC derivatives regulation

Reinsurance

Reinsurance

- Overview
  - Dodd-Frank
    - Relatively limited impact for insurance and reinsurance
    - Reinsurance – changes to credit for reinsurance requirements and reinsurer solvency regulation
    - Surplus lines reform
    - Federal Insurance Office (“FIO”)
  - State-level developments for reinsurance
    - NAIC’s framework and proposed legislation
    - Florida’s changes to credit for reinsurance regulations
    - Proposed changes in New York and New Jersey
  - Implications for reinsurers
  - Potential future developments

Reinsurance

- Federal Insurance Office
  - Based in the US Treasury Department
  - Will cover all lines of insurance except for health insurance, most long-term care insurance, and crop insurance
  - To be responsible for (i) monitoring and reporting on the insurance industry and (ii) acting as the coordinating body on international insurance issues
  - Will recommend to the Financial Stability Oversight Council any insurer or affiliates that should be considered systemically risky nonbank financial companies
  - Information gathering function

Reinsurance

- Preemption
  - Dodd-Frank provides for limited preemption of certain state insurance laws and regulations to the extent that they are:
    - Inconsistent with bilateral or multi-lateral agreements entered into between the United States and foreign nations that enable non-US insurance companies to operate in the US insurance market, or
    - Discriminatory with respect to non-US insurers domiciled in a foreign jurisdiction that is subject to such an international insurance agreement
  - However, Dodd-Frank sets forth details limiting such preemption of state laws and regulations:
    - First, by laying out a process for when preemption may be applied, and
    - Second, by explicitly exempting certain types of state insurance laws and regulations from preemption (including measures regarding insurers' rates, premiums, underwriting or sales practices, state mandatory coverage requirements, state antitrust laws, or capital and solvency requirements that are not discriminatory with respect to non-US insurers)

Reinsurance

- Credit for Reinsurance
  - Dodd-Frank will require credit for reinsurance to be recognized for a ceding company if it is allowed by the ceding company's domiciliary state
    - If such state is an NAIC-accredited state or has financial solvency requirements substantially similar to those necessary for accreditation
  - Laws of the state of domicile of the ceding company will preempt the extraterritorial application of most laws regarding reinsurance from other states
  - Power to regulate reinsurer solvency will be primarily granted to the reinsurer's domiciliary state
    - If such state is an NAIC-accredited state or has financial solvency requirements substantially similar to those necessary for accreditation

Reinsurance

- The NAIC Reinsurance Task Force (“RTF”) has released draft “Reinsurance Collateral Reduction and Accreditation Recommendations” (“RTF Recommendations”), on which the NAIC RTF is seeking comments by 16 September 2010.
- The NAIC RTF is seeking to achieve harmony among various state regulatory initiatives that involve reductions in reinsurance collateral requirements. In addition, the NAIC RTF will consider any changes that might be necessary to the NAIC Credit for Reinsurance Model Law and Credit for Reinsurance Model Regulation.
- These draft recommendations follow upon the adoption by NAIC in 2009 of the draft “Reinsurance Regulatory Modernization Act of 2009”, which the NAIC agreed to submit to the US Congress but which has not yet progressed at the federal level. The draft legislation, in turn, had followed upon the Reinsurance Regulatory Modernization Framework Proposal, which was adopted by the NAIC at the end of 2008.
- The RTF Recommendations are driven to a significant extent by Dodd-Frank, as well as various proposals in certain states for changes to their credit for reinsurance requirements.

Reinsurance

- Florida's Regulatory Changes
  - In 2008, Florida adopted revisions to its credit for reinsurance regulations
  - Similar to NAIC's proposals
  - Apply only to Florida P&C insurers
  - Florida P&C insurers can receive credit for reinsurance from non-admitted reinsurers without 100% collateral if the reinsurer meets certain criteria
    - Non-admitted reinsurer will have to post collateral on a sliding scale (0%, 10%, 20%, 75% or 100%) based on its ratings

Reinsurance

- Florida's Regulatory Changes
  - To qualify for posting reduced collateral, a non-admitted reinsurer must apply to the Florida Office of Insurance Regulation ("FLOIR") and satisfy certain criteria:
    - More than $100 million in surplus
    - Rating of at least "secure financial strength" from at least two major ratings organizations
    - Others, such as good standing with its domiciliary regulator, designating an agent for service of process in Florida, agreeing to be bound by rulings of US courts
  - After evaluating a reinsurer's application, FLOIR can grant an order allowing a non-admitted reinsurer to post less than 100% collateral

Reinsurance

- Florida's Regulatory Changes
  – FLOIR has approved applications from Hannover Reinsurance Co. and XL Re Ltd. in 2010 – for 20% collateral
  – Because of Dodd-Frank, Florida-domiciled P&C insurers only need to satisfy Florida's credit for reinsurance requirements

Reinsurance

- New York's proposed changes to credit for reinsurance regulations
  - Revised version of amendment to credit for reinsurance regulation released by the New York Insurance Department in the past few days
    - No hearing date established yet
    - Previous proposed version was not progressed after NAIC's proposals proceeded
  - New York's credit for reinsurance regulations not to apply if the ceding company's domiciliary state is "an NAIC-accredited state, or has financial solvency requirements substantially similar to the requirements necessary for NAIC accreditation, and recognizes credit for reinsurance for the insurer's ceded risk"

Reinsurance

- New York's proposed changes to credit for reinsurance regulations
  - Ratings-based criteria for reduced collateral from non-admitted reinsurer
    - 0%, 10%, 20%, 75% or 100% collateral requirements depending on ratings
  - Diversification requirements – must notify superintendent if exceed thresholds for reinsurance with a given reinsurer or receivables from a reinsurer or group

Reinsurance

- New Jersey’s pending legislation
  - Proposed amendment to New Jersey’s credit for reinsurance requirements is similar to Florida’s changes
  - Would give commissioner discretion to allow credit for reinsurance for non-admitted reinsurer with no or reduced collateral, if:
    - Reinsurer has more than $250 million in surplus
    - And consideration by commissioner of other factors, such as a secure financial strength rating from at least two nationally recognized statistical rating organizations (including insurer group ratings) and the reinsurer’s domiciliary regulation

Surplus Lines Regulation

Reform of Regulation of Excess and Surplus Lines Insurance

- Title V, Subtitle B of Dodd-Frank is the Nonadmitted and Reinsurance Reform Act of 2010 ("NARRA") – a verbatim copy of the Nonadmitted and Reinsurance Reform Act that was passed by the House in 2006, 2007 and 2009, but went nowhere in the Senate until Senator Dodd baked it into Dodd-Frank
- NARRA, which becomes effective on July 21, 2011, streamlines the patchwork of existing state-by-state regulation of excess and surplus lines in a manner that is designed to make it easier for large commercial purchasers to obtain insurance from companies not admitted to write insurance in their state

Who is eligible to write non-admitted insurance?

- The eligibility of non-admitted insurers for surplus lines placement is being revamped
- Eligibility requirements on US-domiciled non-admitted insurers will be brought into line with the NAIC's Non-Admitted Insurance Model Act
- Eligibility for non-US-domiciled insurers will be assured if the insurer is listed on the NAIC's Quarterly Listing of Alien Insurers

Who is eligible to broker non-admitted insurance?

- No state other than the insured's home state may require a surplus lines broker to be licensed in that state in order to sell, negotiate or solicit non-admitted insurance
- Beginning on July 21, 2012, no state can collect fees for licensing surplus lines brokers, unless it participates in the NAIC's national insurance producer database, NIPR.

Who gets to buy non-admitted insurance?

- Surplus lines brokers can place coverage with non-admitted insurers on behalf of purchasers that meet the statute's definition of "exempt commercial purchaser" without satisfying any state requirement to conduct a due diligence search to determine if the insurance can be obtained from an admitted insurer
- The definition of exempt commercial purchaser is similar to the definition that some states currently have for "industrial insureds"

An “exempt commercial purchaser”:

- employs or retains a qualified risk manager to negotiate insurance coverage
- has paid over $100,000 in property and casualty insurance premiums in the past 12 months, and
- meets at least one of the following criteria:
  - possesses a net worth of $20 million
  - generates $50 million in annual revenue
  - employs more than 500 full-time employees or is a member of an affiliated group that employs more than 1,000 full-time employees
  - is a not-for-profit organization or public entity that generates annual budgeted expenditures of $30 million, or
  - is a municipality with a population in excess of 50,000

Who gets to collect tax on non-admitted insurance?

- Only the home state of an insured party may impose a premium tax on insurance obtained from a non-admitted insurer
- States may enter into compacts to allocate among them the premium taxes paid to a home state, but purchasers of insurance only need to pay one state
- The NAIC is working feverishly to try to develop a framework for allocating non-admitted premium taxes so that it can be enacted by the states before July 21, 2011

GAO Study Mandated

- Within 30 months following enactment of Dodd-Frank, the Comptroller General is directed to study, in consultation with the NAIC, the impact that the changes mandated by Title V of Dodd-Frank have on the size and market share of the non-admitted market

The Volcker Rule

The Volcker Rule

- Prohibits two types of “banking entity” activities
  - Proprietary trading in securities, derivatives and other designated financial instruments.
  - “Sponsoring or investing” in private funds like hedge funds and private equity funds.
- FRB may impose enhanced capital and other financial requirements on nonbank financial companies.

The Volcker Rule

- Complex definitions and exemptions that need to be clarified by regulators
- Long phase-in period
  - Most likely two years before effectiveness of rules, plus a minimum of two years to phase in after that.

The Volcker Rule

- Insurance companies that are affiliated with a bank are "banking entities."
  - Exemption for traditional investment activities of regulated insurance companies
- Insurance groups that are not affiliated with a bank generally avoid prohibitions.
  - Possible opportunity to expand into prop trading and fund activities that banking firms must exit

Closing Remarks

Presented by: David Alberts