

National Regulatory System Proposed for US Insurance Industry

Citing the ongoing economic crisis and the US government's bailout of American International Group, Inc. (AIG), Representatives Melissa Bean (D-IL) and Ed Royce (R-CA) have introduced the National Insurance Consumer Protection Act (H.R. 1880) ("NICPA" or the "Act") in the US House of Representatives. NICPA would create an optional federal charter for insurance companies, insurance agencies, and insurance producers.

Although similar legislative proposals failed to generate broad support in prior sessions of Congress, concern among policy makers over the systemic risk presented to the US financial system by firms such as AIG, and growing concern among life insurers, reinsurers, and some segments of the property and casualty industry over the efficiency and responsiveness of the current system of state regulation have led to renewed interest in the establishment of an optional federal charter (OFC). In introducing NICPA, Rep. Royce stated that "[l]eaving the business of insurance regulation solely to the various state insurance commissioners, while the federal government provides taxpayer-funded assistance is simply irresponsible."

NICPA has been referred to the House Committee on Financial Services, the House Judiciary Committee, and the House Committee on Energy and Commerce; the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises of the House Financial Services Committee has scheduled a hearing for May 14, 2009, on the role of the federal government in insurance regulation. Companion legislation has not yet been introduced in the Senate.

Overview

NICPA is an updated version of previously introduced legislation that called for a national regulatory system to charter and oversee insurers and insurance

producers. Specifically, NICPA creates an Office of National Insurance (ONI) that would be headed by a National Insurance Commissioner (the "Commissioner"). The Act authorizes the Commissioner to issue charters for life insurers, reinsurers, and property and casualty insurers, as well as to issue charters and licenses for insurance agencies and producers. It also provides for the conversion of state-regulated entities to a national charter and the conversion of federally regulated entities to a state charter.

Significantly, unlike prior OFC proposals, NICPA would direct the President to designate a systemic risk regulator for insurers, whether state or federally chartered, and a Coordinating Council for Financial Regulation (the "Council"). NICPA would also add stricter consumer protection standards and allow for the establishment of self-regulatory organizations for nationally chartered and licensed insurers, agencies and producers.

The Act's consumer protection provisions include the establishment of local consumer affairs offices and mandated membership of federally chartered insurers in state, as well as federal, guaranty funds. These provisions are intended, in part, to address concerns leveled at prior OFC proposals, which were criticized for advancing the interests of insurance companies without including provisions to ensure appropriate market practice and insolvency protections for consumers.

Establishment of a Federal Regulator

The ONI would be established as an independent bureau within the Department of the Treasury, much like the Office of the Comptroller of Currency and the Office of Thrift Supervision. The ONI would implement a national system for regulating and supervising federally licensed insurance entities, including: (i) life,

property and casualty, and reinsurance companies and (ii) insurance agencies and producers (i.e., agents and brokers).

The ONI would directly regulate federally chartered insurance companies and would also serve as the federal government's insurance liaison to the systemic risk regulator (SRR), helping identify "systemically important" insurance entities that if not already federally licensed would be required to convert to a national charter. The ONI would otherwise have no authority over state-licensed insurance entities. Such entities would continue to be regulated solely by the states, and state regulation would continue to be coordinated by the National Association of Insurance Commissioners (NAIC). The ONI would be financed through assessments, examination fees and penalties paid by insurers.

The Commissioner would be appointed by the President for a five-year term, subject to the advice and consent of the Senate. The Commissioner could delegate certain of the ONI's duties to one or more self-regulatory organizations. Such self-regulatory organizations would have no authority over state-chartered insurance entities. The Commissioner also would have the authority to engage in international efforts to secure bilateral and multilateral agreements with foreign insurance regulators and regional and global regulatory organizations.

Systemic Risk Regulator

One of the most significant new provisions contained in NICPA is the creation of the SRR. The SRR would be an agency separate from the ONI, designated by the President, and tasked with monitoring the stability of the insurance system (both state and federal), and with guarding against future crises caused by the weakening of the insurance market or the failure of an insurer.

All insurance regulatory bodies (state and national) would be required to share information with the SRR. The SRR would be authorized to recommend to the Commissioner, or to the relevant state insurance regulator, that corrective action be taken to avoid conduct by insurers or affiliates that could have adverse effects on economic conditions and financial stability. In emergency situations, if the Commissioner

or state insurance regulator failed to respond to the SRR's recommendation, the SRR (with approval from the Council) would be able to override the state regulator. As noted above, the SRR, in conjunction with the ONI, also would have the power to require an insurer to be federally chartered if that insurer is deemed to be "systemically important." Thus, under NICPA, some insurers may not have the option to remain under the current state-based system.

Council for Financial Regulators

NICPA establishes the Council, which would be an expanded version of the President's Working Group on Financial Markets.¹ The Council would be chaired by the Secretary of the Treasury and include the Commissioner and the heads of the Federal Reserve System, Securities and Exchange Commission, Commodity Futures Trading Commission, Office of Thrift Supervision, Federal Deposit Insurance Corporation, and the Comptroller of the Currency. The Council would also include a rotating group of three state regulators who would be appointed by the President. The Council would meet at least once every three months and serve as a forum for financial regulators to collectively identify, monitor, and consider issues related to the integrity, status and competitiveness of the financial services industry.

Receivership and the National Guaranty Fund

The Commissioner would be authorized to place a nationally licensed insurer into receivership based on a number of grounds, including insolvency, substantial dissipation of assets, hazardous condition, an inability to meet obligations, and a violation of a law or an order.

NICPA would also establish a National Insurance Guaranty Corporation (NIGC) that would step in when a national insurer is placed into receivership. The NIGC would assume the insurer's obligations to policyholders, in a manner consistent with the terms and limits of guaranty association model acts developed by the NAIC, would function in a manner similar to state guaranty funds, and would be funded by assessments on national insurers.

National insurers would continue to be required to participate in state guaranty associations for each line of insurance sold in any state in which they are

conducting business, thus creating a double assessment for nationally chartered insurers and potentially a substantial disincentive against companies voluntarily converting from a state to a federal charter. State-chartered insurers would still only be required to pay into state guaranty funds.

The provisions regarding the guaranty fund are to be re-assessed within two years of NICPA's enactment in order to determine whether assessments should be imposed before such funds are needed to pay the claims of insolvent insurers, whether national insurers should continue to be members of state guaranty associations, and whether state insurers should have the option of being covered by the NIGC instead of state guaranty associations.

NICPA Chartering Scheme

Under NICPA, insurers, agencies and producers interested in obtaining a federal charter would be required to submit an application to the Commissioner. NICPA authorizes the Commissioner to issue charters for national insurers for life insurance, property and casualty insurance, and reinsurance. A holding company would be permitted to own both a national life insurer and a national property and casualty insurer. National insurers would receive a license from the ONI and would be permitted to write business nationally. NICPA permits US branches of non-US insurers to be chartered as national insurers and for insurers to be organized in a form other than a corporate form. The Act does not specify how the regulatory and supervisory scheme discussed below would be applied to branches of non-US insurers that are already subject to regulation and supervision under their home country laws.

Not all insurance is covered under NICPA; title insurance is exempted from NICPA, and the status of health insurance under NICPA is unclear. Comprehensive health insurance is not explicitly addressed in the Act. The NICPA definition of "life insurance" only includes disability income insurance, long-term care insurance and supplemental health insurance. The Act's definition of "property and casualty insurance" includes a reference to insurance against "loss of health," which could indicate that property and casualty insurers may write comprehensive health insurance. It could also refer to insurance incidental to property and

casualty insurance, such as workers' compensation insurance, which is different from comprehensive health insurance.

If "loss of health" in the Act's definition of property and casualty insurance is meant to include comprehensive health insurance, that would represent a break from the current, uncontroversial industry practice of allowing both life insurers and property and casualty insurers to write accident and health insurance. It is more likely that comprehensive health insurance was deliberately left out of the Act, possibly in deference to the anticipated health insurance proposal of the Obama Administration. This ambiguity in the Act regarding health insurance undoubtedly will be addressed as it proceeds through Congress.

National insurance agencies and producers could obtain a federal charter or license authorizing them to sell insurance for any nationally chartered or state-licensed insurer, including surplus lines and non-admitted insurance for a non-admitted insurer. Any producer who remains state licensed would be able to sell insurance on behalf of a national insurer, provided that any such sales are only within states in which such producer is licensed.

Supervision of Federally Chartered Insurers

Under NICPA, the Commissioner would have broad supervisory and regulatory powers. The Commissioner is mandated to develop standards addressing accounting and disclosure, auditing, risk management, investments, capital and liquidity, actuarial opinion, reinsurance and other matters relating to financial stability. In developing such standards, NICPA requires the Commissioner to consider certain NAIC standards, including financial, policy, and market conduct standards. The Commissioner is also responsible for establishing reporting and examination requirements and risk-based capital, liquidity, dividend, and operational and other standards for national insurance holding companies and their subsidiaries to ensure their solvency and stability.

NICPA authorizes the Commissioner to issue corrective orders to national insurance holding companies and their subsidiaries in the event they are engaging in any activity that the Commissioner determines to be (i) a significant risk to the solvency of a national insurer,

(ii) jeopardizing the interests of policyholders, or (iii) incompatible with the public interest. Such corrective orders would be subject to judicial review.

NICPA does not address the potential overlap of regulatory authority for insurance holding companies that own banks or thrifts and thus are subject to other regulatory holding company schemes such as the Bank Holding Company Act or the Savings and Loan Holding Company Act. For instance, the Act does not discuss how the ONI would share authority with the Board of Governors of the Federal Reserve System if the insurance holding company were also a bank holding company.

The Commissioner will have authority to review and approve mergers, consolidations, and acquisitions of control of national insurers, as well as transactions between national insurers and their affiliates. This is similar to the authority currently vested in state insurance regulators. Additionally, NICPA contains provisions that would provide a full release for the transferring insurer in bulk transfers of blocks of insurance business. These provisions will greatly facilitate transactions of this type, which are currently hampered by a lack of uniform state standards providing for such a release.

The Commissioner will oversee the establishment and implementation for national insurers, insurance agencies and insurance producers of internal risk control practices that are designed to detect and prevent violations of law, regulation or other requirements. If a violation is detected, national insurers, insurance agencies and insurance producers would be required to self-report. National insurers and insurance agencies and producers also would be required to submit reports, as requested, to the Commissioner. Failure to self-report a violation could be the basis for an enforcement action against the institution or its employees.

National insurers would be subject to on-site examinations by the Commissioner at least once every two years. In addition, national insurance agencies and producers could be subject to examinations in response to a complaint or evidence of a violation of the law or regulations.

The enforcement power of the Commissioner is modeled after the remedies available to federal banking agencies. The Commissioner will have the ability to (i) revoke or suspend a charter or license; (ii) issue a cease-and-desist order; (iii) remove or suspend individual officers, directors, controlling shareholders, agents and consultants; and (iv) issue civil money penalties.

NICPA also requires the Commissioner to establish regulations requiring insurers and insurance agencies to design and implement procedures for compliance with anti-money laundering laws, including (i) the establishment of internal controls; (ii) compliance testing; (iii) training; and (iv) designation of individual(s) responsible for coordinating and monitoring compliance with anti-money laundering laws.

Applicability of State Laws

Despite the national insurance regulatory scheme established under NICPA, certain categories of state law would continue to apply to certain activities and operations of nationally chartered insurers. These categories include: (i) state tax laws; (ii) unclaimed property and escheat laws; (iii) laws related to participation in assigned-risk plans or other mandatory residual-market mechanisms that are designed to make insurance available to those unable to obtain insurance in the voluntary market; (iv) laws that provide for compulsory coverage of workers' compensation or motor vehicle insurance; (v) laws mandating participation in an advisory or statistical organization; and (vi) laws related to participation in state guaranty funds. However, to the extent any of the above categories of state law would require a national insurer to use a particular rate, rating element, price or form, a national insurer would not be subject to such state law.

Consumer Protections

To address one of the main criticisms of prior legislative proposals for an optional federal charter (namely, the risk of a de-emphasis on consumer protection in any statutory scheme that facilitates preemption of state law), the Act includes extensive consumer protection provisions. The Act would establish a Division of Consumer Affairs within the ONI, which would in

turn create in each state a local Office of Consumer Affairs with a local, direct phone number. NICPA also requires the Commissioner to establish a web site and a toll-free telephone number for consumer education and to receive and address questions and complaints. In addition, the Commissioner would be required to issue market conduct regulations implementing model laws of the NAIC to prevent unfair and deceptive practices.

Outlook for NICPA

NICPA currently has only two co-sponsors, and similar legislation introduced in 2006 and 2007 failed to pass the House or the Senate. Support for and opposition to NICPA within the industry remain substantially the same as have been observed in relation to prior bills aimed at creating optional federal regulation of insurance: the life insurance and reinsurance segments of the industry and certain segments of the property and casualty sector support the legislation, while most property and casualty insurers as well as state insurance commissioners, the NAIC, and certain consumer protection groups support continued state regulation of the industry. The inclusion of property and casualty insurance in NICPA could prove to be a stumbling block in its adoption, as that has long been a point of contention both within the industry and within Congress.

The ongoing financial crisis and the actions that the Obama Administration takes in response to that crisis may ultimately determine the fate of NICPA or similar OFC proposals. Unlike past years, when the passage of OFC legislation was stymied by stand-offs among large life insurance companies, states' rights advocates and consumer groups, this year the issue is more likely to be determined by how Congress and the Obama Administration choose to deal with systemic risk and financial regulatory reform, and whether, and to what extent, insurance is included in those efforts. If some form of an optional federal charter is established in 2009, it will probably not be through a standalone bill such as NICPA; rather, it is more likely to be an aspect of the financial regulatory reform legislation that ultimately is approved by Congress. Likewise, the form and function of the federal insurance regulator will depend on the outcome of the larger regulatory reform debate.

Similar bills have failed in the past due to strong opposition from the NAIC and other groups. However, in response to the government bailout of AIG, the Administration and Congress are likely to establish some level of federal supervision over the insurance industry. In turn, as a condition for accepting federal regulation, many in the insurance industry will insist on an optional federal charter. The financial crisis, ensuing industry bailouts, and the regulatory reform efforts have altered the political landscape, making an optional federal charter much more likely to pass than in years past.

Financial regulatory reform is still in its nascent stages in Congress. The Senate Banking Committee has held one hearing on modernizing insurance regulation (although the issue of insurance regulation has come up in the context of other hearings that have examined the issue of financial regulatory reform generally), but a companion bill to the Act has not yet been introduced in the Senate. Similarly, insurance has been discussed in some House Financial Services Committee hearings on regulatory reform, and a hearing on the issue has been scheduled for May 14, 2009, in the House Subcommittee on Capital Markets, Insurance, and Government Sponsored Entities.

In a related development, Capital Markets and Insurance Subcommittee Chair, Rep. Paul Kanjorski (D-PA), indicated that he might re-introduce a bill that he introduced in 2008 (H.R. 5840), that would establish within the Department of the Treasury the Office of Insurance Information, headed by a Deputy Assistant Secretary, to: (i) collect, analyze, and disseminate information and issue reports regarding all lines of insurance except health insurance; (ii) establish federal policy on international insurance matters and ensure that state insurance laws are consistent with agreements between the United States and a foreign government or regulatory entity; and (iii) advise the Secretary of the Treasury on major domestic and international insurance policy issues. He also said in recent remarks before the North American Securities Administrators Association that some form of federal regulation of insurance was "going to happen" but cautioned against acting too swiftly. However, House Financial Services Committee Chairman Barney Frank (D-MA) recently assessed the odds of creating a federal insurance regulator at

“50-50,” although he noted that the odds would improve significantly if the proposal was narrowly focused and only targeted life insurance.

Endnote

¹ The President’s Working Group on Financial Markets is currently chaired by the Secretary of the Treasury, and includes the Chairs of the Federal Reserve Board, the Securities and Exchange Commission, and the Commodity Futures Trading Commission.

If you have questions regarding NICPA, or any other matter raised in this Client Update, please contact the Mayer Brown attorney with whom you normally communicate or any of the following attorneys.

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