

April 13, 2009

## National Insurance Consumer Protection Act and Prospects for Federal Regulation of Insurance

### Introduction

In the midst of worldwide regulatory reform efforts due to the economy's dramatic downturn over the past year, Congress is moving forward with plans to provide for the additional federal regulation of the insurance industry and optional federal chartering of insurance companies. On April 2, Representatives Ed Royce (R-Calif.) and Melissa Bean (D-Ill.) announced the introduction of H.R. 1880, the National Insurance Consumer Protection Act (NICPA). The NICPA was referred to three House committees: Financial Services; Judiciary; and Energy and Commerce. The bill offers insurers and producers the option to charter at the federal level and grants a federal insurance regulator expanded powers and the ability to compel oversight of firms deemed "systematically important."<sup>1</sup> The bill has been referenced repeatedly by Congressman Barney Frank (D-Mass.), the Chairman of the House Financial Services Committee, in outlining his committee's agenda.<sup>2</sup> In addition, the Obama Administration appears poised to move forward, based on statements of Treasury and Federal Reserve Board personnel.<sup>3</sup>

Strong support for the federal regulation of the insurance industry exists off of Capitol Hill and includes major insurance and bank trade associations, independent groups such as the Group of Thirty,<sup>4</sup> and foreign financial regulators. The Government Accountability Office has also recently suggested the need to explore centralized regulation of insurance at the federal level.<sup>5</sup> While significant opposition to such regulation exists, most notably by the National Association of Insurance Commissioners (NAIC) and state legislators, the substantial federal financial support provided to insurance giant AIG, and recently announced plans to provide federal support for certain insurers, make greater federal regulation of the insurance industry a virtual certainty. Whether or not this occurs through the NICPA or some other legislation designed primarily to address systemic risk<sup>6</sup> or resolution authority<sup>7</sup> for financial-related firms remains to be seen.

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<sup>1</sup> See, e.g., Ed Royce, Press Release, *OFC Sponsors Prepared to Introduce Beefed-Up Federal Insurance Regulator Bill*, Feb. 11, 2008, available at <http://royce.house.gov/News/DocumentSingle.aspx?DocumentID=110979>.

<sup>2</sup> See SUTHERLAND LEGAL ALERT "Federal Insurance Regulation: An Updated Scorecard" (Mar. 12, 2009) (Please click [here](#) to view the legal alert).

<sup>3</sup> Steven Sloan, *Fed Insurance Charter an Option*, AM. BANKER, Feb. 26, 2008; see also Scorecard Alert.

<sup>4</sup> Mark A. Hoffman, *Group of 30 Urges National Insurance Regulation*, BUSINESS INS., Jan. 15, 2009. The Group's report, *Financial Reform: A Framework for Financial Stability*, was authored by Paul Volcker, former Federal Reserve Chairman and current "special advisor" to President Obama.

<sup>5</sup> GAO, *Financial Regulation: A Framework for Crafting and Assessing Proposals to Modernize the Outdated U.S. Financial Regulatory System*, GAO-09-310T (Washington, D.C., Jan. 8, 2009).

<sup>6</sup> See the Financial System Stabilization and Reform Act of 2009, S. 664 (Mar. 23, 2009) (sponsored by Sen. Collins).

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Set forth below is an overview of the current version of the NICPA. We will be tracking the bill's progress as well as other legislative and regulatory developments impacting the insurance industry. Please feel free to contact us with any questions or concerns pertaining to the NICPA or these developments.

## National Insurance Consumer Protection Act

The NICPA comes on the heels of federal insurance charter legislation proposed in previous years.<sup>8</sup> The NICPA proposes establishing a federal insurance regulator to supervise federally chartered National Insurers, National Agencies (legal entities) and National Producers (individuals); all aspects of regulation would be subject to federal standards and receivership of such entities would be under federal law. Insurers could opt for governance under the current state-driven scheme or the new federal regulatory structure. States would be required to recognize the federal licenses and generally not interfere with the business of a National Insurer. The NICPA would, however, permit states to tax National Insurers operating within the state, and provides several other areas where states would be able to participate in regulation or supervision of National Insurers. Notably, National Insurers would be required to participate in state guaranty associations. Under the NICPA, states would maintain the responsibility for regulating state licensed insurers and producers.

The inclusions in the NICPA of provisions for a Systemic Risk Regulator and Coordinating Council for Financial Regulators (Council) distinguish the NICPA from previous legislative efforts. Under the NICPA, all insurance commissioners, both state and national, would be required to share information with a Systemic Risk Regulator. The Systemic Risk Regulator would be tasked with making corrective action recommendations to federal or state insurance regulators to mitigate or avoid actions taken by an insurer or its affiliates that would have serious adverse effects on economic conditions or financial stability. In certain circumstances, the Systemic Risk Regulator can, with the approval of the Council, directly order or establish rules to address its recommendations, and can cause state insurers to become federally chartered under certain circumstances. The Council, composed of the Secretary of the Treasury, the National Insurance Commissioner (Commissioner), and the heads of other government agencies in the financial sector, would serve as a forum for financial regulators to identify issues related to the health and competitiveness of the financial services industry.

A summary of the relevant provisions of the NICPA can be found below:

### New Regulator

The NICPA establishes an Office of National Insurance (ONI) in the Department of the Treasury headed by the Commissioner.<sup>9</sup> The President would appoint the Commissioner to a five-year term, subject to the

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<sup>7</sup> See the Treasury Department's draft legislation called the "Resolution Authority for Systemically Significant Financial Companies Act of 2009" prepared in conjunction with Secretary Geithner's March 26, 2009 testimony to the House Financial Services Committee.

<sup>8</sup> Versions of the current legislation have been debated by market participants, regulators and Congress since 2001. The most recent prior version, the National Insurance Act of 2007 (NIA) would have allowed insurers to elect regulation under a state-run system or regulation by the federal government under an optional federal charter; the NIA was derived from a 2006 version of the bill introduced in the 109th Congress. The NIA was sponsored by Tim Johnson (D-S.D.) and John Sununu (R-N.H.) in the Senate (S. 40). Representatives Royce and Bean also sponsored H.R. 3200 in 2007, the House version of that act. We note that Sen. Sununu lost his re-election bid to former governor Jeanne Shaheen in 2008.

<sup>9</sup> National Insurance Consumer Protection Act of 2009, § 101(a), H.R. 1880 (Apr. 2, 2009).

advice and consent of the Senate.<sup>10</sup> The Commissioner's powers would include overseeing the organization, incorporation, operation, regulation and supervision of National Insurers and National Agencies.<sup>11</sup> These responsibilities would include granting charters and licenses, issuing regulations, and determining agency and insurer compliance.<sup>12</sup> Additionally, the NICPA creates two divisions within the ONI: the Division of Insurance Fraud and the Division of Consumer Affairs.<sup>13</sup>

The NICPA also establishes the Office of the Ombudsman to act as a liaison between the ONI and any National Insurer, Agency, Producer or affiliated party adversely affected by ONI actions.<sup>14</sup> The Ombudsman could review the policies and procedures of the ONI and make recommendations to the Commissioner,<sup>15</sup> but would not have the authority to review the appointment of a receiver, preliminary examination conclusions, cease-and-desist orders, or civil fines.<sup>16</sup>

Assessments on regulated entities would fund the ONI, together with fees imposed for examinations and processing various applications, filings statements, notices or requests for approval. Start-up funds for the office could be borrowed from the Secretary of the Treasury, to be repaid with interest over a 30-year period.<sup>17</sup>

## Systemic Risk Regulation

The NICPA requires the President, with the consultation of the Chairman of the Senate Committee on Banking, Housing and Urban Affairs and the House Committee on Financial Services, to appoint a Systemic Risk Regulator within 90 days of the enactment of the NICPA.<sup>18</sup> The President is required to appoint a "federal agency" that has "experience in financial regulation and supervision" as the Systemic Risk Regulator.<sup>19</sup> Interestingly, this approach allows for NICPA to move forward even if a new Systemic Risk Regulator for all financial activities has not been named yet through other legislation,<sup>20</sup> as the

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<sup>10</sup> *Id.* § 101(b)(2).

<sup>11</sup> *Id.* § 102(a)(1).

<sup>12</sup> *Id.* § 102(a)(2).

<sup>13</sup> *Id.* §§ 105, 106.

<sup>14</sup> *Id.* § 107(b).

<sup>15</sup> *Id.* § 107(c).

<sup>16</sup> *Id.* § 107(d).

<sup>17</sup> *Id.* § 115.

<sup>18</sup> *Id.* § 201(a).

<sup>19</sup> *Id.*

<sup>20</sup> We note that the first legislative effort to create a comprehensive systemic risk regulator appears to be the Financial System Stabilization and Reform Act of 2009 (S.644). That Act establishes a "Financial Stability Council" consisting of the heads of a number of federal agencies and regulators to conduct systemic risk oversight and enforcement.

President could name an existing federal agency. All state insurance commissioners, as well as the Commissioner, would be required to share requested information with the Systemic Risk Regulator.<sup>21</sup>

The scope of the Systemic Risk Regulator's power would extend to any "covered institution," which includes National Insurers as well as any insurance company organized and supervised under state law.<sup>22</sup> Importantly, the powers granted to the Systemic Risk Regulator also generally apply to affiliates of covered institutions, including their holding companies. Based on the Systemic Risk Regulator's examinations of the activities and operations of covered institutions, the Regulator could make corrective action recommendations to the Commissioner or applicable state commissioner to mitigate or avoid actions taken by the insurer or its affiliate that would have serious adverse effects on economic conditions and financial stability.<sup>23</sup> If the Commissioner or state regulator does not take the recommended action, the Systemic Risk Regulator is authorized to issue an order or rule to address the activities upon a determination of a two-thirds vote of the Council finding that the "corrective action is necessary to mitigate or avoid an impending serious adverse affect on economic conditions or financial stability."<sup>24</sup> Any such order imposed is subject to judicial review by a U.S. Court of Appeals.

Notably, the Systemic Risk Regulator, in consultation with the Commissioner, could mandate a state chartered insurer found to be systemically important to become a National Insurer.

### Coordinating Council for Financial Regulators

The NICPA establishes the Council, which would serve as a forum for financial regulators to collectively identify and consider issues related to the regulation and supervision of financial services firms.<sup>25</sup> These issues could include the stability and integrity of financial markets, investor and consumer protection, the efficiency and effectiveness of regulation and supervision, and other matters of mutual concern.<sup>26</sup>

The Council would be headed by the Secretary of the Treasury and would include the Chairman of the Federal Reserve, the Chairman of the Securities and Exchange Commission, the Chairman of the Commodity Futures Trading Commission, the Comptroller of the Currency, the Director of the Office of Thrift Supervision, the Chairman of the Federal Deposit Insurance Corporation, the Commissioner, and three individuals representing state securities, insurance and banking regulatory interests appointed by the President.<sup>27</sup> The Council would meet at least every 90 days, sharing information as necessary to fulfill

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<sup>21</sup> NICPA at § 201(b)(1).

<sup>22</sup> *Id.* § 201(g).

<sup>23</sup> *Id.* §§ 201(b)(3), 201(b)(5).

<sup>24</sup> *Id.* § 201(b)(4).

<sup>25</sup> *Id.* § 202(a).

<sup>26</sup> *Id.*

<sup>27</sup> *Id.* §§ 202(c), 202(d)(2); note that council members, as necessary and appropriate, would be permitted to designate a senior policymaking official to represent the member at a meeting.

its statutory functions.<sup>28</sup> Once every year, the Council would be required to submit an annual report to the President, Congress, and the governors and legislatures of each state on its activities.<sup>29</sup>

The Council would not have any independent supervisory or regulatory authority except with respect to its role described above related to the Council's determinations allowing the Systemic Risk Regulator to issue orders or rules to enforce its recommendations that are not acted upon by the Commissioner or a state insurance regulator.<sup>30</sup>

## National Insurer Charters and Holding Companies

The NICPA authorizes the chartering of National Life Insurers, National Property/Casualty Insurers and National Reinsurers. NICPA limits the underwriting activities of a National Insurer to those permitted under its charter.<sup>31</sup> Under the current language in the NICPA, it appears that a charter could potentially permit more than one line of insurance to be underwritten; it is anticipated, however, that the underwriting of life insurance and property/casualty insurance be done through separately chartered entities.<sup>32</sup> In any event, holding companies may own separately chartered National Life Insurers and a National Property/Casualty Insurers.

The NICPA provides for extensive regulation of National Insurance Holding Companies and any of their subsidiaries. The Commissioner has the authority to: (1) review changes in control of a National Insurer; (2) examine a holding company and its subsidiaries; (3) require reports of a holding company and its subsidiaries; (4) oversee and potentially prohibit the non-insurance activities of the holding company that pose risks to the insurer or the public; (5) promulgate capital and other financial standards for the holding company; and (6) regulate affiliated transactions.

Any change in control of a National Insurer is subject to a notice and review procedure.<sup>33</sup> If the Commissioner does not disapprove the change in control within 60 days, the change in control is permitted. The Commissioner also is afforded the ability to impose two 45-day extensions to the review period.

The NICPA also provides that any National Insurance Holding Company, and each subsidiary of such holding company, must file any reports that the Commissioner may require with the Commissioner.<sup>34</sup> In addition, any such holding company or subsidiary is also subject to examination by the Commissioner.

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<sup>28</sup> *Id.* §§ 202(e), 202(g).

<sup>29</sup> *Id.* § 202(h).

<sup>30</sup> *Id.* § 202(b)(2).

<sup>31</sup> *Id.* § 301(a)(2).

<sup>32</sup> See Fact Sheet: National Insurance Customer Protection Act, *available at* [http://www.house.gov/apps/list/press/il08\\_bean/National\\_Insurance\\_Consumer\\_Protection\\_Act\\_Fact\\_Sheet.pdf](http://www.house.gov/apps/list/press/il08_bean/National_Insurance_Consumer_Protection_Act_Fact_Sheet.pdf). This approach would be consistent with the separateness required under the NIA.

<sup>33</sup> NICPA at § 502.

<sup>34</sup> See *Id.* § 503.

The Commissioner would be responsible for promulgating rules for National Insurance Holding Companies with regard to capital, liquidity, dividends, operations and other standards.<sup>35</sup> If the Commissioner determines that a National Insurance Holding Company or its subsidiary is engaged in activity that poses a significant risk to the solvency of a National Insurer, jeopardizes the interest of the insurer's policyholders, or is incompatible with the public interest, the Commissioner may take enforcement action against the company after notice and a hearing.<sup>36</sup>

Affiliate transactions would be required to fall within a reasonable standard and could be subject to further regulation. Any extraordinary dividends (defined in relation to the outstanding liabilities of an insurer and its financial needs) would be subject to the Commissioner's approval.<sup>37</sup>

### Non-United States Insurers

The NICPA allows non-United States insurers to transact business in the United States by chartering a United States branch as a National Insurer.<sup>38</sup> In so doing, the Commissioner may take into account capital and assets located outside of the United States. While the Commissioner may not impose conditions on such insurers merely because of their ownership by a non-United States person, conditions may be imposed if they are related to the protection of policyholders and are necessary to achieve the purposes of the NICPA.

### Supervision of National Insurers and National Agencies

National Insurers under the NICPA would be subject to market conduct standards based upon model laws and regulations developed by the NAIC.<sup>39</sup> The Commissioner would be required to conduct on-site examinations of National Insurers no less than once every 24-month period.<sup>40</sup>

The Commissioner would be required to conduct an examination of a National Agency in response to complaint or other evidence of a violation of law, written condition or written agreement.<sup>41</sup> However, the Commissioner could examine affiliates of both National Insurers and National Agencies to discover information regarding the affiliate's activities that may materially affect the operations, management or financial condition of the National Insurer or National Agency.

### Prudential Supervision

The NICPA imposes on the Commissioner the duty to issue regulations on prudential supervision of National Insurers, National Agencies and National Insurance Producers. For example, the NICPA requires that such insurers, agencies and producers establish and implement internal risk control

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<sup>35</sup> *Id.* § 504.

<sup>36</sup> *Id.* § 503(c).

<sup>37</sup> *Id.* § 505.

<sup>38</sup> *Id.* § 301(c).

<sup>39</sup> *Id.* § 313.

<sup>40</sup> *Id.* § 112(b)(1). We note that this requirement is more stringent than the 36-month period required under the NIA.

<sup>41</sup> *Id.* § 112(b)(2).

practices and procedures that are designed to prevent and detect violations of laws and regulations,<sup>42</sup> and to require self-reporting of violations of laws and regulations, and remediation thereof. In addition, the NICPA requires prudential regulations be adopted that address many aspects of the manner in which investigations, examinations, and the enforcement penalties thereunder may be imposed.<sup>43</sup>

### Impact of State Laws

State laws regarding licensing examinations, reporting, regulation or supervision would *not* apply to National Insurers, Agencies or Producers under the NICPA. However, National Insurers, National Agencies and National Producers would be subject to: (1) state unclaimed property and escheat laws; (2) state tax laws; (3) state laws regarding mandatory residual market rules to provide insurance to those who may be unable to gain insurance in the voluntary market; (4) compulsory coverage requirements of motor vehicle insurance; (5) laws regarding participation in advisory or statistical organizations; and (6) laws regarding workers' compensation administration.<sup>44</sup>

### Prompt Corrective Action

The NICPA requires the Commissioner to promulgate regulations consistent with the recommendations of the Comptroller General to ensure prompt corrective action is taken to resolve any hazardous financial condition of a National Insurer.<sup>45</sup> To identify the appropriate structure of procedures and requirements, the NICPA orders a report be made by the GAO taking into account the prompt corrective action requirements of the Federal Deposit Insurance Act with respect to insured depository institutions as well as the NAIC's "Model Regulation to Define Standards and Commissioner's Authority for Companies Deemed to be in Hazardous Financial Condition."

### Powers of National Insurers and National Agencies

National Life Insurers would be permitted to: (1) provide life insurance, annuities, disability income insurance, long-term care insurance, or funding agreements (and incidental benefits) payable in fixed or variable amounts; (2) establish one or more separate accounts; (3) hold and accumulate funds pursuant to funding agreements; (4) provide investment advice and investment management services; and (5) engage in activities incidental to the insurance activities. In addition to providing property and casualty insurance, Property/Casualty Insurers would be specifically permitted to establish one or more protected cells in connection with an insurance securitization.

The NICPA permits National Agencies to sell insurance written by any National Insurer or state insurer.<sup>46</sup> In addition, state licensed agencies are permitted to sell National Insurers' policies within the states that they are licensed. With respect to surplus lines insurance, the NICPA permits only the "home state" of the insured to tax surplus lines transactions involving multi-state risks and provides some protection for

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<sup>42</sup> These appear to be similar to many of the requirements imposed on FINRA member broker-dealers.

<sup>43</sup> NICPA at § 111(b)(3)-(6).

<sup>44</sup> *Id.* § 109(b).

<sup>45</sup> *Id.* § 125.

<sup>46</sup> *Id.* § 304(a)(2)(A).

federally licensed surplus lines brokers against duplicative state regulation.<sup>47</sup> The NICPA defines the “home state” of an insured as the state in which the insured has its principal place of business or the state of residency if the insured is an individual.

National Agencies would also be permitted to engage in claims adjustment and settlement, risk management, employee benefits advice, retirement planning and any other insurance-related consulting activities. These definitions with respect to “consulting” are generally broader than the standard definitions under state law for insurance agencies or producers.<sup>48</sup>

### Discrimination Under State Laws

The NICPA exempts National Insurers, National Agencies and National Producers from the application of state laws unless expressly provided for in the NICPA. The proposed law also prohibits states from discriminating against state insurers or producers intending to convert to a federal charter or affiliated with federally chartered insurers.<sup>49</sup>

### Antitrust Laws

The NICPA also subjects National Insurers, National Agencies and National Producers to federal antitrust laws subject to limited exceptions, including dissemination and use of standard insurance policy forms and to the extent exempted under Section 3 of the McCarran Ferguson Act.<sup>50</sup>

### Form, Governance, Capital

National Insurers and National Agencies may organize as a corporation, partnership, limited liability company or any other business form recognized under state law.<sup>51</sup> Additionally, the NICPA permits stock, mutual and fraternal forms.<sup>52</sup> In determining whether to issue a charter to a National Agency or Insurer, the Commissioner will consider factors including the character and competency of the parties seeking the charter, the financial prospects of the applicants and the prospects of the proposed agency or insurer.<sup>53</sup>

Under NICPA, because there is no federal corporate law, a National Insurer and a National Agency must determine and state in its bylaws the applicable corporate law to which it will adhere. It may choose among: (1) the state in which its main office is located; (2) the state in which its holding company is

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<sup>47</sup> *Id.* § 323.

<sup>48</sup> See e.g., Sections 2 and 3 of the NAIC’s Producer Licensing Model Regulation.

<sup>49</sup> NICPA at § 701.

<sup>50</sup> *Id.* § 702. It appears the NICPA reference should be to §2 of the McCarran Ferguson Act since §3 was only applicable until June 30, 1948.

<sup>51</sup> *Id.* § 301(a)(1).

<sup>52</sup> *Id.* § 301(a)(1)(A).

<sup>53</sup> *Id.* § 301(b).

incorporated; (3) Delaware law; or (4) the Model Business Corporation Act.<sup>54</sup> A National Life Insurer in mutual form may elect to either adhere to participating policy procedures of the relevant law of the state in which its main office is located or adhere to policy procedures established by the Commissioner.<sup>55</sup> Subject to certain exceptions, each National Insurer and National Agency must establish an independent audit committee of its board of directors, composed entirely of outside directors independent of management.<sup>56</sup> This requirement may be satisfied if a company controlling the National Insurer or National Agency has formed such a committee and that committee reviews the financial statements of such insurer or agency.

The NICPA provides for Commissioner supervision of certain transactions including the acquisition of control of a National Insurer, mergers involving a National Insurer, bulk transfers,<sup>57</sup> reorganization of a U.S. branch of an alien insurer as a National Insurer in stock form, and stock-to-mutual and mutual-to-stock conversions.

## Producer Licensing

The Commissioner has the power to issue National Producer licenses to individuals.<sup>58</sup> The NICPA provides for the creation of an electronic database of all federally licensed Producers to support communication between the ONI and state insurance regulators.<sup>59</sup> A self-regulatory organization (SRO) may be delegated authority to maintain the producer database.<sup>60</sup>

A federal license also authorizes Producers to sell, solicit or negotiate surplus lines and non-admitted insurance. A state insurance producer without a federal license may sell, solicit or negotiate insurance on behalf of a National Insurer in the states where the producer is licensed.<sup>61</sup> The Commissioner is required to create standards of supervision for nationally licensed Producers.

Under the provisions of the NICPA, a National Insurer has a duty to supervise the sales and marketing practices of a federally licensed individual insurance producer if: (1) the producer is an employee or agent; and (2) the entire or principal activity of the producer is devoted to sales, solicitations or negotiations of insurance policies for the National Insurer. These provisions appear to require an insurance company to supervise the activities of its “captive” producers. Further, a National Agency must supervise a national insurance producer if: (1) the producer is an employee of the National Agency and

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<sup>54</sup> Subject to the approval of the Commissioner, a National Insurer or National Agency may designate any of its insurance operations offices as the main office. The charter shall specify the state in which its main office is located. For purposes of judicial jurisdiction, citizenship is deemed to be where the main office is located and, if different, the state in which the principal place of business is located. *Id.* at § 302.

<sup>55</sup> *Id.* § 302(d).

<sup>56</sup> *Id.* § 302(c)(1).

<sup>57</sup> A transaction that, according to the NICPA, has a similar purpose to “assumption reinsurance.”

<sup>58</sup> NICPA at § 401. We note that this terminology differs from that used by the NAIC and specific state insurance regulators that often refer to “producers” as comprising both legal entities and individuals holding insurance licenses.

<sup>59</sup> *Id.* § 403(a).

<sup>60</sup> *Id.* § 403(b).

<sup>61</sup> *Id.* § 401.

the act is within the scope of employment of the producer; or (2) the producer is an agent of the National Agency and the sale, solicitation and negotiation of insurance is pursuant to the terms of an agreement between the agent and the National Agency. If a federally licensed insurance producer is not subject to supervision by a National Insurer or National Agency, then the Commissioner will directly oversee the producer.

### Self-Regulatory Organizations

Under the NICPA, an approved SRO could undertake, pursuant to the Commissioner's oversight, rulemaking as well as many of the day-to-day regulatory responsibilities otherwise entrusted to the Commissioner. Similar organizations composed of regulated entities have been used in other federal regulatory environments but not yet for insurance regulation. The SRO allowed for under the NICPA could investigate and respond to customer complaints in a uniform manner much like the Financial Industry Regulatory Authority (FINRA) and the national exchanges do in the securities industry.

While SROs may not be delegated any of the key regulatory powers of the Commissioner (e.g., reviewing and approving chartering, conversions, bulk transfers, and holding company regulation and oversight), SROs could enforce its members' compliance with NICPA provisions, regulations promulgated by the Commissioner and SRO rules. Any rules established by SROs or disciplinary actions taken by SROs would be subject to the Commissioner's ability to review, approve or modify.<sup>62</sup>

### Financial Standards, Market Conduct and Policy Standards

The Commissioner is charged with establishing standards, by regulation, for National Insurers and National Agencies on: (1) accounting and disclosure; (2) auditing; (3) risk management; (4) internal controls; (5) investments; (6) capital and liquidity; (7) actuarial opinions; (8) reinsurance; and (9) other matters impacting financial stability and integrity.<sup>63</sup>

The Commissioner would promulgate market conduct regulations governing National Insurers, National Agencies and National Producers. The regulations should "implement" the NAIC's Unfair Trade Practices Act and Unfair Claims Settlement Practices Act.<sup>64</sup>

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<sup>62</sup> *Id.* § 108(b).

<sup>63</sup> *Id.* § 311.

<sup>64</sup> *Id.* § 313.

Regulations covering both general policy requirements and requirements for specific classes of policies, would follow the enactment of the NICPA. The policy form and a certification stating that the policy is in compliance with the regulations would be filed with Commissioner before any policy form is issued to customers.<sup>65</sup>

In establishing the financial, policy and market conduct standards required, the Commissioner would be required to take into consideration standards, models, practices and instructions established by the NAIC.<sup>66</sup>

### Enforcement Powers of the Commissioner

Under the NICPA, the Commissioner would have the power to revoke or restrict the charter of a National Insurer, or a National Agency, or revoke the license of National Producer.<sup>67</sup> These enforcement powers are patterned after those available to the federal banking regulators, permitting the Commissioner to: (1) revoke or suspend a charter or license; (2) issue a cease-and-desist order; (3) remove or suspend individual officers, directors, controlling shareholders, agents and consultants; and (4) impose civil penalties. The NICPA clarifies expressly that these powers are applicable to any National Insurance Holding Company and any of its subsidiaries.<sup>68</sup>

### Conversions

Pursuant to Commissioner-created regulations, existing insurers and agencies may convert from a state charter to a national charter under the NICPA in a process similar to that found in federal banking law.<sup>69</sup> Conversely, a National Insurer or National Agency could convert to a state insurer or agency in accordance with applicable state laws after notifying the Commissioner of their intention to convert.<sup>70</sup> The Commissioner would have discretionary authority to permit a National Insurer to retain assets, liabilities, powers and authorities that do not otherwise conform to the legal requirements of a National Insurer or National Agency.<sup>71</sup> The Commissioner would not be able to delegate any authority with regard to conversions to any insurance SRO.<sup>72</sup>

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<sup>65</sup> *Id.* § 312.

<sup>66</sup> *Id.* § 314.

<sup>67</sup> *Id.* § 121.

<sup>68</sup> *Id.* § 122.

<sup>69</sup> *Id.* § 303(a)(1).

<sup>70</sup> *Id.* § 303(b).

<sup>71</sup> *Id.* § 303(a)(3).

<sup>72</sup> *Id.* § 303(c).

## Division of Insurance Fraud and the Division of Consumer Affairs

As described above, the NICPA creates a Division of Insurance Fraud headed by a Director. The NICPA would make insurance fraud against a National Insurer a federal crime, requiring National Insurers to give a fraud warning to insurance applicants and claimants and report fraudulent insurance acts to the Commissioner. The Act also includes provisions that mandate restitution by persons convicted of committing insurance fraud, and if the fraud injured a National Insurer, Agency or Producer, the Act authorizes a civil action to recover against the individual or group that perpetrated the fraud.<sup>73</sup>

The Division of Consumer Affairs would also be headed by a Director. The Division would serve as a liaison between the ONI and consumers. Significantly, the NICPA provides for the establishment of an office of the Division of Consumer Affairs to be established in each state.<sup>74</sup> There would also be a centralized call center with a toll-free number and an Internet address for the Division to accept complaints. This approach of establishing an office in every state may be viewed as a response to a common argument against a federal charter for insurers: that local offices create a greater stake in responding to customer complaints, and are more accessible to consumers.

## Variable Products

The NICPA makes no express mention of variable annuity or life insurance products. We note that the 2007 NIA required the Commissioner to establish, by regulation, standards for supervision that did not conflict with the FINRA rules or federal securities law and regulations. The NICPA does contemplate that one of the powers of a National Insurer is to create separate accounts, although it does not provide much detail around such separate accounts or, for example, their insulation from general account assets and/or insurance company creditors.<sup>75</sup> Given the prevalence and importance of such products in the life insurance market and the myriad issues raised by such products since they involve both the issuance of securities and insurance, it can be reasonably anticipated that the new law and regulations thereunder would ultimately address such products.

## Solvency

Given the amount of federal financial support provided to AIG at the holding company level, solvency regulation and governmental commitments to backstop insurers and their holding company's obligations have generated considerable, if not the most, attention during the most recent legislative debate surrounding a federal insurance charter.

The NICPA would establish the National Insurance Guaranty Corporation under the leadership of a Director appointed by the Commissioner.<sup>76</sup> The National Insurance Guaranty Corporation would be funded by assessments imposed against all National Insurers; in general, the Director would impose assessments against a National Insurer only if such an insurer is in the same type of business as the

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<sup>73</sup> *Id.* § 123.

<sup>74</sup> *Id.* § 105.

<sup>75</sup> *Id.* § 304(a)(1)(B).

<sup>76</sup> *Id.* § 602(b).

National Insurer that is placed into receivership.<sup>77</sup> These assessments would follow the typical state model; they would not be imposed until such funds are needed to fund claims on an insolvent insurer. National Insurers required to pay assessments would receive written notice of the assessment payable 30 days after the date of receipt.

Notwithstanding the creation of the National Insurance Guaranty Corporation, National Insurers would be required to also participate in the relevant state guaranty associations in each state where they do business and must pay assessments to that association, provided the state does not charge an assessment rate or otherwise treat the National Insurer in a different manner than a state insurer.<sup>78</sup> However, states are not permitted to impose a premium tax, franchise tax, income tax, retaliatory tax, or other primary tax applicable to insurance companies on any National Insurer, unless the Insurer can recoup such assessments in the same manner and extent as a state insurer.<sup>79</sup>

We note that unlike insurance coverage for bank deposits that is handled entirely at the federal level through the Federal Deposit Insurance Corporation, NICPA calls for a bifurcated approach that requires a National Insurer to effectively participate in both state and federal guaranty associations. The current version of the NICPA provides little detail as to how these two funds will interact, if at all. Perhaps responding to this bifurcated structure, within two years of the enactment of the NICPA, the Director of the National Insurance Guaranty Corporation would be required to give a recommendation on whether National Insurers should continue to be members of state guaranty associations and whether State insurance commissioners should be given the opportunity to require State insurers to be covered by the National Insurance Guaranty Corporation.<sup>80</sup>

## Receivership and Conservatorship

The NICPA provides for an administrative receivership wherein the Commissioner may appoint a person as the receiver of a National Insurer for the purposes of rehabilitation or liquidation.<sup>81</sup> The grounds for establishing a receivership include: (1) insolvency; (2) substantial dissipation of an insurer's assets or earnings due to violations of law or risky practice; (3) further transactions of the National Insurer would be hazardous, financially or otherwise, to policyholders, creditors or the public, (4) willful violation of a cease-and-desist order; (5) concealment of financial records; (6) inability to meet obligations; (7) violation of law; (8) the consent of shareholders or the board of directors; or (9) money laundering.<sup>82</sup> We note that the powers of the Commissioner do not extend in any manner to provide for a conservator or receiver of a National Insurance Holding Company or its subsidiaries that are not National Insurers.<sup>83</sup>

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<sup>77</sup> *Id.* § 606(b)(1)(A). We note that in determining whether a National Insurer is in the business of providing the same type of insurance as the national insurer placed into receivership, the Director may consider subsets of property/casualty insurance or life insurance as different types of insurance.

<sup>78</sup> *Id.* § 605(a).

<sup>79</sup> *Id.* § 605(b).

<sup>80</sup> *Id.* § 606.

<sup>81</sup> This follows the federal banking law model wherein the Federal Deposit Insurance Corporation (FDIC) is appointed for insured national banks.

<sup>82</sup> NICPA at § 601(b).

<sup>83</sup> See *supra* note 7 discussing the Treasury's proposal for resolution of certain financial firms.

With respect to the payment of claims on life insurance policies of a National Insurer placed into receivership for liquidation, such claims shall be paid in a manner consistent with the Life and Health Insurance Guaranty Association Model Act of the NAIC.<sup>84</sup>

## State Taxes

The NICPA would not deny tax revenue to a state just because an insurer doing business in the state is a National Insurer.<sup>85</sup> With certain exceptions, a National Insurer doing business in a state is subject to applicable state and local taxes, assessments and charges, including insurance retaliatory taxes. A National Insurer would not be subject to taxes or charges imposed for failure to be a state insurer or special assessments for services the state does not provide. The National Insurer would also be entitled to all applicable tax credits, deductions and offsets provided under state law to the same extent and manner as an insurer licensed to do business in a state and chartered in the state where the National Insurer is domiciled.<sup>86</sup> Further, National Insurers would be subject to a premium tax on surplus lines insurance only in the state where it has its principal place of business or, if the insured is an individual, in the state where the insured is resident.<sup>87</sup>

A National Agency would be subject to state tax only in its domicile state and only to the extent that other state insurance agencies are taxed.<sup>88</sup>

## Demutualization

A National Insurer could convert from mutual to stock form, although such insurers would be subject to greater regulation regarding conversion and would need advanced approval from the Commissioner.<sup>89</sup> While many states permit mutual insurers to partially convert by establishing mutual holding companies, the NICPA omits any mention of the mutual holding company form.

## International Agreements

The NICPA authorizes the Commissioner to engage in international efforts to secure bilateral and multilateral agreements with foreign insurance regulators and regional and global regulatory organizations. The policy behind this provision is meant to: (1) promote the stability and integrity of insurance markets; (2) encourage open and fair competition; and (3) improve the quality and uniformity of insurance supervision and regulation internationally.<sup>90</sup>

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<sup>84</sup> NICPA at § 603(a).

<sup>85</sup> *Id.* § 321.

<sup>86</sup> The NICPA specifies the process through which a state can determine whether a National Insurer or National Agency is domiciled in that state.

<sup>87</sup> NICPA at § 323.

<sup>88</sup> *Id.* § 322(c).

<sup>89</sup> *Id.* § 304(d).

<sup>90</sup> *Id.* § 203(a).

In addition, the Commissioner may provide technical assistance to, and cooperation with, foreign insurance regulators and regional and global regulatory organizations. In exercising this authority, the Commissioner would consult with the Executive Office of the President and the United States Trade Representative.<sup>91</sup>

We note that the ability to formally interact with foreign insurance regulators has been an oft-repeated reason for the need for some form of federal insurance regulation.



*We will continue to monitor developments related to the regulatory reform initiatives impacting our insurance company clients. If you have any questions regarding this Legal Alert, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.*

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<sup>91</sup> *Id.* § 203(c).