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Recent Developments: The Federal Regulation of Insurance

Congress and the Obama Administration continue to work on substantial regulatory measures to reform the regulation of the financial services industry, ranging from the oversight of credit default swaps to the formation of a systemic risk regulator and the possibility of federal regulation of insurance. Democratic Congressional leaders have vowed to pass major reform legislation before the end of the year, although the precise contours of such legislation remain unclear.

With respect to the federal regulation of insurance, the picture appears to be coming a little more into focus. Such regulation is likely to include some or all of the following: (1) a more comprehensive form of resolution authority for insurance holding companies and their subsidiaries; (2) oversight of insurance companies and their holding companies by a systemic risk regulator that, through its own authority, or through direction to other regulators, can compel such entities to maintain adequate capital levels and to take certain corrective actions; and (3) the establishment of a federal insurance regulatory authority and an optional federal chartering process for insurers. The prospects for federal regulation of insurance could perhaps be increased as a result of the Treasury Department's recent approval to provide funds to certain life insurers through the Capital Purchase Program (CPP.)

Below is a description of recent developments that provide insight into the reform process and the possible regulation of insurance companies at the federal level.

TARP Money Approved for "Insurers"

The Treasury Department recently agreed to provide up to \$22 billion of aid to six life insurers requesting such aid through the CPP.¹ Under the CPP, institutions requesting funding would receive federal funds in return for issuing certain preferred shares to the Treasury Department. Requests for participation in the CPP were due in November 2008. During the long wait for Treasury approval, many life insurance companies took other steps, such as stock and debt offerings, to shore up their financials. Importantly, only bank and savings and loan holding companies are eligible to receive CPP funds, so that only insurance company enterprises that also own banks or thrifts are eligible for participation in the CPP. It is unclear whether and to what extent those institutions that were granted access to the CPP funds will actually make use of them, as at least two institutions have indicated they will not participate despite receiving approval to do so.

House Hearing: "How Should the Federal Government Oversee Insurance?"

On May 14, 2009, the House Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises (the Subcommittee) received testimony from five witnesses on the federal regulation of insurance.² Rep. Paul Kanjorski (D-PA) serves as chairman of the Subcommittee and opened the hearing with a statement focusing on "how," not "whether," the federal government should regulate insurance:

¹ The CPP is one initiative of the Treasury Department under the Troubled Asset Relief Program (TARP).

² Testimony was provided by: Blair Webel, Specialist in Financial Economics, Congressional Research Service; Scott E. Harrington, Professor, University of Pennsylvania; Patricia L. Guinn, Managing Director, Towers Perrin; Martin Grace, Professor, Georgia State University; and J. Robert Hunter, Director of Insurance, Consumer Federation of America.

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The events of the last year have demonstrated that insurance is an important part of our financial markets. The Federal government therefore should have a role in regulating the industry. As such, we now must ask how the Federal government should oversee insurance going forward.

While a number of Representatives made opening statements, Rep. Melissa Bean (D-IL) took the opportunity to highlight the differences in her current, proposed legislation, “The National Insurance Consumer Protection Act,” HR. 1880 (NICPA), from prior federal insurance chartering legislation.³ Rep. Bean rebutted the primary arguments against permitting an optional federal charter: the risk of regulatory arbitrage, and the lack of “local” responsiveness when a federal, rather than state, agency oversees customer complaints. In describing the newly minted concepts in NICPA, Rep. Bean focused on the following topics:

- The applicability of NICPA to holding companies and their subsidiaries;
- The measure under NICPA to prevent regulatory arbitrage by limiting the ability of federally chartered insurers to flee to state regulation;
- The creation of systemic risk regulation of both federally and state chartered insurers; and
- The creation of local offices of the federal insurance regulatory authority in each state.

While the witnesses did not present a unified view of the manner in which insurance should be addressed at the federal level, a number of the witnesses cautioned against applying the “banking law” model for oversight of insurers.⁴ In addition, a significant portion of the hearing focused on systemic risk regulation, and how the insurance industry should be subject to such regulation. While there was no consensus on the dimensions of systemic regulation (e.g., whether specific insurers should be designated as systemically important, and what form such a regulator should take—a council of sitting regulators, a new federal regulatory organization or an existing agency), some witnesses suggested that the interrelationships of insurers and their holding companies with the financial markets could create systemic risk.

Joint Trade Association Letter Submitted to Congress

A group of financial services trade associations, including insurer, reinsurer and producer groups, submitted a joint letter dated April 29, 2009 (Joint Letter), to the Chairman and Ranking Member of the Senate Banking Committee and of the House Financial Services Committee.⁵ The Joint Letter indicates that state regulation “should remain available for those who choose it.” However, it indicates that “structural limitations” of the state system, and “the fact that insurance has become a global, integrated business” leads to the need for strong and uniform federal regulation of insurance companies, producers and holding companies. The Joint Letter includes a one-page “Outline for Federal Insurance Regulation” that focuses on 10 principles that are “essential components of insurance regulation reform” including, among others: market stability oversight; solvency regulation; consumer protection; continuing viability of state premium taxes; and appropriate guaranty fund coverage.

³ See Sutherland Legal Alert “National Insurance Consumer Protection Act and Prospects for Federal Regulation of Insurance” (Apr. 13, 2009)(Please click [here](#) to view this legal alert.)

⁴ See, e.g., Statement of Scott E. Harrington, University of Pennsylvania; Statement of Patricia L. Guinn, Towers Perrin.

⁵ See Letter from Agents for Change, American Bankers Association, American Bankers Insurance Association, American Council of Life Insurers, American Insurance Association, The Council of Insurance Agents and Brokers, The Financial Services Roundtable, and Reinsurance Association of America to Chairman Dodd, Chairman Frank, Ranking Member Shelby, and Ranking Member Bachus (Apr. 29, 2009) (Please click [here](#) for a copy of the letter.)

GAO Report: Insurance Reciprocity and Uniformity

The Government Accountability Office (GAO) delivered a report in April 2009 to certain members of the House Financial Services Committee entitled “Insurance Reciprocity and Uniformity: NAIC and State Regulators Have Made Progress in Producer Licensing, Product Approval, and Market Conduct Regulation, but Challenges Remain” (GAO Report).⁶ The report follows on the GAO’s January 2009 report titled “Financial Regulation: A Framework for Crafting and Assessing Proposals to Modernize the Outdated U.S. Financial Regulatory System,” in which the GAO suggests “Congress could consider the advantages and disadvantages of providing a federal charter option for insurance and creating a federal insurance regulatory authority.”⁷

The GAO Report examines the degree of reciprocity and uniformity in state insurance regulation in three areas: (1) producer licensing; (2) product approvals; and (3) market conduct examinations and regulation. While the GAO Report chronicles some of the successes state insurance regulators have achieved in streamlining regulation of those areas, it also indicates that more work remains to be done. For example, with respect to producer licensing, it focuses on the inability of many states to perform full criminal background checks of their agents using fingerprinting on applicants as part of their producer licensing programs. The GAO Report highlights some of the more intractable issues that the NAIC faces in working toward uniformity, or even reciprocity, in state insurance regulation because of the different state statutory standards and marketplace realities in each state.



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 attorneys with whom you regularly work.

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⁶ The GAO Report is available from the GAO’s Website here: <http://www.gao.gov/new.items/d09372.pdf>.

⁷ See Sutherland Legal Alert “A Scorecard on the Systemic Risk Regulator and Federal Insurance Regulation” (Feb. 9, 2009) (Please click [here](#) to view this legal alert.)