CUG.COMments

A Newsletter from Chicago Underwiting Group, Inc.
Underwriters of D & O and Professional Liability Insurance

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In this issue … The Finance Reform Bill; Old Republic is again one of "Ward's 50"

FINANCIAL REFORM ENACTED

Introduction

After months of anticipation and debate, the Dodd-Frank Wall Street Reform and Consumer Protection Act (PDF) became law on July 21, 2010, when it was signed by President Obama. The act will touch virtually every part of financial activity in America—how extensively and to whose benefit or detriment will likely not emerge for many months. This issue of CUG.COMments will limit its discussion of the act to those parts which directly affect the insurance industry.

Background

Following the federal government announcing its intention to introduce finance reform legislation, in March 2009 (PDF) this newsletter addressed some of the lively regulatory discussions within the insurance industry,. Opposing camps took the general positions that either "everything is fine" or "current regulation is outdated and inefficient." Hovering above the debate was the specter or savior—depending on your feelings—of federal intervention, something which had essentially been absent since the McCarran-Ferguson Act of 1945. The enactment of the Dodd-Frank legislation has temporarily suspended the speculation.

The Dodd-Frank Act and the Insurance Industry

Out of the act's nearly 850 pages and more than 540 Sections, insurance accounts for just sixteen pages and sixteen sections, reflecting a general belief that the insurance industry had not caused the financial crisis and so was in less need of reform. These insurance elements can be broadly summarized as follows.

A Federal Insurance Office

The creation of this office was not unexpected; the question was how extensive it would be. Some reformers had wanted a federal insurance presence in every state, but that ambitious goal was not realized. The new Federal Insurance Office (FIO) will be within the Department of the Treasury and will be overseen by a Director, to be appointed by the Treasury Secretary. The role of the Director will include monitoring "all aspects of the Insurance Industry" with particular reference to:

- How traditionally underserved communities have access to insurance (other than health insurance).
- Helping out with the Terrorism Risk Insurance Program established under the Terrorism Risk Insurance Act (TRIA).
- Acting as the U.S. representative on international insurance matters, and consulting with state regulators on national and international "matters of importance."

In carrying out these duties, the Director is authorized to gather data as appropriate, with some restrictions. The director's authority does not extend to health insurance, long-term care insurance or crop insurance.

The director may "preempt," or become involved with, state insurance matters to the extent that a state measure results in a non-U.S. insurer receiving less favorable treatment than a U.S. domiciled insurer. Beyond that, the director has virtually no supervisory or regulatory authority over the states.

Director Reports

The director will nonetheless be kept busy writing reports for Congress; these reports are to address:

- Any preemption by the director of inconsistent state insurance actions as described above.
- The insurance industry.
- The global reinsurance market and how it supports insurance in the U.S.
- The ability of state regulators to access reinsurance information following the act's reinsurance features (see below).
- How to modernize and improve the system of insurance regulation in the United States.

Nonadmitted Insurance

The act introduces some significant efficiencies for the nonadmitted (surplus lines) sector. Perhaps the most notable provision is that "no state other than the home state of an insured may require any premium tax payments for nonadmitted insurance." This should help eliminate competing and sometimes incompatible tax demands made by the states over surplus-lines placements. Allocation agreements to divide up the surplus lines' tax between states will be allowed, but the principle that tax is actually collected in just one state is sensible and practical (and could probably only have been effected by such a federal dictate).

Regulation of surplus-lines placements, including broker licensing, shall be governed by the home state of the insured. Uniform standards for surplus-lines eligibility and streamlining of placements for "commercial purchasers," as defined, are also addressed. Further, states may not prevent surplus-lines brokers from placing business with nonadmitted insurers listed in the National Association of Insurance Commissioners' (NAIC) *Quarterly Listing of Alien Insurers*. An extensive study is to be made of the nonadmitted insurance market and submitted to Congress, but this study will be undertaken by the Comptroller General of the United States, rather than by the FIO Director.

Reinsurance

Little more than one page is given to reinsurance, a sector largely unseen and unknown by the general public outside the industry. Reinsurance currently has minimal state regulation, and these three sections of the act are mostly concerned with internal industry issues. They broadly address: (a) that the ceding insurer's state of domicile will generally be the regulatory authority for dispute resolution and contract issues, (b) that the ceding insurer's state of domicile shall regulate credit taken by the ceding insurer for reinsurance, and (c) that only the reinsurer's state of domicile is responsible for regulating a reinsurer's solvency.

Comment

With state regulatory authority still firmly in place and with no reference in the act to a parallel federal charter system for insurance companies, the states' rights adherents, as led by the NAIC, may have avoided their biggest fears. The carefully worded NAIC news release hints at its relief: "We were pleased to see that the Federal Insurance Office (FIO) set up under the bill is narrowly designed to carry out its mission while not unnecessarily undermining strong state regulation."

The nonadmitted market has gained some clear benefits from the act; a news release from NAPSLO, the surplus-lines industry trade group, declares itself "pleased that the industry's goal to reform and modernize surplus lines regulation and premium tax laws has been accomplished."

Life insurers were probably hoping for more than they received. The American Council of Life Insurers (ACLI), a leading trade group, had been courting and encouraging federal oversight and had heard little discouragement from policy-makers. But without the federal charter the ACLI had been seeking, all it could muster in its release was to rather tamely "welcome the creation of the Federal Insurance Office."

The Reinsurance Association of America has not yet issued any public comment on the act, perhaps reflecting its disappointment. The Association has been a firm proponent (PDF) of exclusive federal oversight for the reinsurance sector, but *Dodd-Frank* appears only to clarify the existing authority of the states over reinsurance, rather than remove it.

Talking in the abstract about federal intervention is very different from actually having it take place. *Dodd-Frank* has given the federal government a foot in the door and it is unlikely that foot will be withdrawn. With a new job in a new federal entity, the director of the FIO will probably feel impelled to do some directing; as Mark Twain is supposed to have said, “To a man with a hammer, everything looks like a nail.”

The regulatory monopoly of the NAIC has been preserved for now, but the FIO was not created because that regulation was working well. By setting up a FIO and director, *Dodd-Frank* allows legislators to sidestep the line of fire from the rival factions. These efforts at persuasion will now have to be redirected to an individual who is not elected and therefore relatively immune from the traditional blandishments of the lobby system. When it comes to future legislation, members of Congress may find it easier to simply endorse the director’s recommendations than justify their own.

Postscript

The bulk of *Dodd-Frank* addresses the financial world aside from insurance. The act requires some 250 rules to be formulated by various regulatory bodies and has ordered that around 100 studies are to be carried out. The ultimate results of the act will therefore not likely be known until these rules have been made, implemented and tested, and the findings of the studies evaluated. Although largely avoided by the direct provisions of the act, it is quite possible that the insurance industry will feel a significant secondary effect as its policyholders wrestle with the demands of their new regulatory landscape.

WARD’S 50 FOR 2010

Old Republic Insurance Group has again been recognized by the Ward Group (PDF) as one of the “Ward’s 50.” Each year the Ward Group analyzes more than 3,000 U.S. domiciled property-casualty insurance companies and identifies the top performers based on a set of criteria averaged over the past five years; these include:

- Return on average equity.
- Return on average assets.
- Return on total revenue.
- Improvement in surplus to written premium.
- Combined ratio.

We are proud to be a member of this select group.❖

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