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Underwriters of D & O and Professional Liability Insurance

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….This issue of CUG.COMments looks at Dodd-Frank, two years on.

INTRODUCTION

July marks the two-year anniversary of the federal Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") becoming law. We look at how some of the provisions relating to insurance have played out so far.

RECAP

Our newsletter of July 2010 described the impact of Dodd-Frank on the insurance industry. An important feature was the creation of a Federal Insurance Office (FIO) and the position of Director to lead that office, marking a small but significant federal encroachment into the fiercely protected world of state-controlled insurance regulation. The most clearly defined task for Director Michael T. McRaith was for him to prepare and submit various reports: Progress so far is mixed.

WAITING FOR THE REPORT

The first report —on how to modernize and improve the system of insurance regulation in the United States— was due to be delivered to Congress by the end of January 2012. As of the time of writing, it had yet to be released, making it nearly six months late. In his defense, it was not until March 2011 that Mr. McRaith was named director. However, critics might point out that he waited until October 17, 2011 to solicit public comment for the report.

Regular readers of this newsletter will know of the deep division between the current proponents of the regulatory status quo, led by the National Association of Insurance Commissioners (NAIC), and those who wish to introduce a measure of federal control in the hope that this would mitigate some of the industry's burden in responding to 50 separate regulatory regimes.

Mr. McRaith acknowledged this division in a speech on January 12, 2012 at the Insurance Information Institute. Speaking about a recent conference, he noted there had been "robust discussion, but rather little agreement." Mr. McRaith added, "Indeed, the conference highlighted the diversity within the insurance sector on even the most basic questions."

No official reason for the delay has been offered. Part of the problem might be the impossibility of satisfying both camps, so a middle ground is being sought that causes the fewest objections; the upcoming elections probably compound the difficulty.

NEXT REPORT ALREADY IN THE WINGS

Even as the clamor mounts over the late report, Mr. McRaith has recently announced he is seeking public comment on his next report: "The Global Reinsurance Market." This second FIO report will likely not raise as many hackles as the first. Reinsurance is generally viewed as an arrangement between knowledgeable insurance professionals, with little direct impact on the general public. Prior to Dodd-Frank, reinsurance was lightly regulated, and Dodd-Frank assigned the subject barely a page, with provisions that mostly solidified a reinsurer's state of domicile as its main regulator.

Dodd-Frank & Surplus Lines

Dodd-Frank offered what appeared to be a sensible solution to the historic problem of how to allocate surplus-lines taxes where there are multi-state exposures: Simply have all the tax paid to the insured's home state. With a nod to the old arrangements, the act then provides for states to enter into "compacts" that will continue to allocate the taxes among themselves.

In what might be a metaphor for the current fragmented condition of 50-state insurance regulation, two separate and essentially competing "compacts" emerged. One, known as NIMA (Non-admitted Insurance Multi-state Agreement) was set up under the leadership of Florida. After a shaky start it got even shakier: Alaska, Connecticut, Hawaii, Mississippi, Nebraska and Nevada all dropped out before the pact was launched. This leaves just five states: Florida, Louisiana, Utah, South Dakota and Wyoming —plus Puerto Rico. NIMA has the support of the National Association of Insurance Commissioners.

The other group, Surplus Lines Insurance Multi-State Compliance Compact (SLIMPACT), is faring only marginally better. It is currently stuck (and has been since early in 2012), on nine member-states: Kentucky, Vermont, Tennessee, Indiana, Kansas, Alabama, Rhode Island, New Mexico and North Dakota. This is one state short of the self-imposed minimum of ten needed to implement the program. SLIMPACT is supported by the National Association of Professional Surplus Lines Offices (NAPSLO) and the National Conference of Insurance Legislators (NCOIL).

The third way —paying all the tax to the insured's home state as envisioned by the act— is the likely approach of the remaining states, which include the surplus-lines power houses of California, New York and Texas and whose combined surplus-lines premium comprises nearly half the national total.

NIMA and SLIMPACT were formed in an attempt by states to hold on to surplus-lines tax received as a result of the old allocation methods. With current membership of both "compacts" small and shrinking, those member-states are likely evaluating the net benefit, if any, of collecting reciprocal taxes from their few fellow-members, versus keeping all their "home-grown" tax themselves.

Comment

Implementation of the entirety of the Dodd-Frank requirements has been delayed in virtually every government agency that was assigned tasks. For the Securities and Exchange Commission, which has been coping with dozens of new rules and studies on top of its existing workload, there may be some sympathy. For the newly formed Federal Insurance Office, with no backlog of old issues and already six months overdue on its first report, sympathy might be less forthcoming.

By permitting the creation of multi-state pacts to cling on to surplus-lines tax revenue, Dodd-Frank threatened to muddy the waters, but the moribund condition of the two pacts signals a struggle for relevance. That struggle may indirectly support those who believe the role of the states should be diminished. ❖

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