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Once More Into the Fray: National Insurance Consumer Protection Act Revives Optional Federal Charter Discussion

On April 2, 2009, Representatives Melissa Bean (D-IL) and Ed Royce (R-CA) introduced a bill, the National Insurance Consumer Protection Act (H.R. 1880) (the "NICPA" or the "Act"), that would allow insurers and insurance producers to elect federal regulation. The NICPA is similar to the proposed National Insurance Act ("NIA") optional federal charter bills introduced in 2006 and 2007 which failed to pass Congress ("2006 NIA" and "2007 NIA"). The NICPA responds to concerns in the life insurance industry as well as some segments of the property and casualty industry that the current system of state insurance regulation is riddled with inefficiencies, discourages and delays the development of innovative products, imposes unnecessary compliance costs and puts insurers at a substantial disadvantage compared to the banks and investment firms with which they compete in many markets. In addition, some see AIG's troubles and the systemic crisis in the financial system as evidence of the need for regulatory reform in the insurance industry.

The NICPA builds on concepts introduced in the 2006 NIA and 2007 NIA, but adds new concepts such as a systemic risk regulator and a Coordinating Council for Financial Regulation (the "Council"). Because we have discussed the optional federal charter framework in earlier client alerts, this client alert will focus on a number of issues in the NICPA that we think need to be addressed, clarified or closely considered by those shaping the proposed legislation and those considering a federal charter. For a more thorough review and analysis of optional federal charter bills please refer to our previous *Client Alerts* dated May 3, 2006 and June 21, 2007 entitled [Optional Federal Charter Bill: Proposed Alternative To State Insurance Regulation](#), and [Optional Federal Charter Bill Reintroduced: Proposed Alternative To State Insurance Regulation Returns for Another Round](#) available through our website.

Brief Overview of NICPA

As in the 2006 NIA and 2007 NIA, the Act would establish an independent Office of National Insurance within the Treasury Department to be headed by a Commissioner of National Insurance (the "Commissioner") appointed by the President. The bill would permit new insurers (both life and property and casualty insurers) and insurance agencies to be organized under federal law and permit existing state regulated insurers and agencies to

convert to federal charters. The Act would regulate and provide for the licensing of all such insurers ("national insurers") and agencies ("national insurance agencies") as well as other qualifying producers who elect to be regulated under federal law. National insurers and national insurance agencies would have the right to conduct business in all states and U.S. territories and would generally be free of state insurance regulation, except for certain categories of state law, including state tax laws, state laws related to participation in residual market plans, state laws that provide for compulsory coverage of workers' compensation or motor vehicle insurance and participation in state guaranty funds. States would continue to regulate insurers and producers that retain state charters and licenses.

NICPA Regulatory Structure

Principles Based Regulation

The Act contemplates a principles based regulatory regime with many of the specific details to be spelled out in rules and regulations to be promulgated by the Commissioner after enactment. See the discussion of principles-based regulation in our November 8, 2007 *Client Alert* entitled [New York Insurance Department Releases Draft of Principles-Based Regulation](#). Thus, the Act delegates to the Commissioner the responsibility for developing the extent to which national insurers and national insurance agencies would be regulated. The Act requires that regulations be in place before the Commissioner issues any charters. Interested insurers and agencies will not be able to make informed decisions regarding whether or not to seek a federal charter until the regulations are promulgated.

One unique regulatory aspect of the Act is that it permits the Commissioner to establish one or more insurance self-regulatory organizations to carry out the purposes of the NICPA and enforce compliance with the Act. Implementation of this self-regulatory scheme will involve a number of challenging constitutional and restraint of trade questions.

Expansive Holding Company Regulatory Authority

The NICPA grants the Commissioner broad regulatory power to regulate not only national insurers, but also their non-insurance affiliates and subsidiaries. The Commissioner's authority extends beyond the current system of state insurance regulation where such authority is limited to regulating the non-insurance affiliates' transactions with the insurer.

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Moreover, the Commissioner is directed to establish capital, liquidity, dividend, operational, and any other standards for a national insurance holding company that the Commissioner deems appropriate to ensure solvency and sound operation of the national insurer. No national insurer or national insurance agency may establish or acquire a subsidiary without prior notice to the Commissioner, and the Commissioner's prior approval is required for a broad range of corporate transactions which might not currently be subject to prior approval under state regulation.

The Commissioner also has broad power to take action against any national holding company or affiliate that the Commissioner determines has engaged in any activity that the Commissioner believes poses a significant risk to the solvency of a national insurer, jeopardizes the interests of the policyholders or is incompatible with the public interest. Furthermore, the systemic risk regulator (discussed below) has the power to examine and restrict activities of non-insurance affiliates to protect the financial system.

Systemic Risk Regulator

In a nod to the regulatory scheme discussed below outlined by Treasury Secretary Tim Geithner, the NICPA establishes a "systemic risk regulator." The President is to designate a federal agency experienced in financial regulation and supervision as the systemic risk regulator. The systemic risk regulator is authorized to recommend corrective actions to the Commissioner and state commissioners designed to prevent an insurer or its affiliates from taking actions that would have serious adverse effects on financial stability. If the Commissioner or state commissioners fail to take timely corrective action, the systemic risk regulator, with the consent of the Council (which consists primarily of banking, securities and commodities regulators), can act on its own and overrule the Commissioner or state commissioner. The systemic risk regulator is authorized to request information from any federal or state insurer, its affiliate or its regulator, and may participate in examinations of such insurer or its affiliates.

Any insurance company that is deemed to be "systemically important" would be required to obtain a charter under the Act, making the federal charter mandatory for those insurers that are deemed systemical-

ly important. The agency designated as systemic risk regulator, in consultation with the Commissioner, will determine if an insurance company is systemically important and if such insurer should be required to be chartered under the Act.

Treasury Secretary Geithner highlighted the importance of addressing systemic risk in his testimony before the House Committee on Financial Services on March 26, 2009. The Treasury Secretary plans to create higher standards for all systemically important financial firms – regardless of whether they own a depository institution – "to account for the risk that the distress or failure of such a firm could impose on the financial system and the economy." Providing a single agency with authority to "supervise, examine, and set prudential requirements for...critical parts of the financial system," which would include systemically important insurance entities, is critical to Secretary Geithner's plan to overhaul the financial regulatory system. More details are expected to be published in the coming weeks, but it is likely that the systemic risk regulator contemplated by the NICPA may ultimately be addressed by separate legislation sponsored by the Treasury that would regulate systemically important firms across all sectors of the financial system.

Chartering and Business Authority

Single v. Multiple Lines

The NICPA provides that national charters may only be issued for (i) property and casualty insurance, (ii) life insurance, or (iii) the reinsurance of property and casualty insurance and life insurance. While the release accompanying the NICPA appears to envision a national charter that would permit a national insurer to engage in only one of these types of businesses, the text of the NICPA is much broader and can be read as authorizing the Commissioner the discretion to license an insurer for all lines of business. If the intent of the Act is indeed to limit national insurers to only one of the above three enumerated categories of business, the legislation needs to be clarified.

Health Insurance

While the 2006 NIA appeared to permit health insurance to be written by national insurers, the 2007 NIA appeared to exclude health insurance. The NICPA definition of

life insurance does not include comprehensive health insurance, but the definition of property and casualty insurance includes insurance for "loss of health." It is unclear whether "loss of health" is meant to permit property and casualty insurers to write ordinary health insurance. This uncertainty is exacerbated by the lack of clarity about the Commissioner's authority to license broadly across life and P&C lines. Life insurers with substantial amounts of health insurance may be discouraged from converting to a federal charter if they have to convert to a P&C charter or transfer health insurance to a separately licensed national insurer. Ordinary health insurance should either be clearly included or excluded from the Act, and if included, the Act should clearly spell out which charters authorize writing comprehensive health insurance to remove the current ambiguity.

Non U.S. Insurers

The Act provides that a non-U.S. insurer may charter a branch to do business as a national insurer. The Commissioner may give appropriate recognition to capital and other assets maintained by the non U.S. insurer in a jurisdiction other than the United States. However, non-U.S. holding companies are subject to the examination and reporting requirements imposed on U.S. holding companies only if authorized by an international agreement.

Guaranty Fund, Assessments and Taxes

Dual Guaranty Funds & Double Assessments

National insurers will be subject to federal receivership procedures and will not be subject to liquidation by the states. In addition, the NICPA establishes the National Insurance Guaranty Corporation ("NIGC") which will pay claims consistent with the NAIC Model Guaranty Fund Acts when a national insurer is placed into receivership for liquidation. Even though the NIGC is funded by assessments on national insurers, national insurers will also be required to participate in state guaranty associations for lines of insurance which the insurer writes in each state. This means that national insurers would be subject to double assessments as they would be supporting two separate guaranty fund systems.

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The double assessments could be temporary, as within two years of enactment, the Act requires a report to Congress from the Director of the NIGC as to whether national insurers must continue to pay into the state guaranty funds and whether states can permit state insurers to participate in the NIGC. It appears the intent of mandating the report is to undertake a wholesale review of the entire guaranty fund system and, based on the results of this report, significant changes to the guaranty fund system may be made. Because the Commissioner will not be able to charter national insurers until necessary regulations are in place, and this could potentially be a lengthy process, it is possible the report to Congress will have been completed and the provisions regarding the guaranty fund system will be completely overhauled before insurers must decide about converting to a federal charter. However, if this is not the case and there are very few initial national insurers in the NIGC, an insolvency of a national insurer could lead to an unusually large assessment.

Double Taxation

National insurers will also be subject to applicable state and local taxes, assessments and charges (including premium taxes) as well as assessments and fees necessary to fund the Office of National Insurance. As a result, any insurer considering whether to become a national insurer will have to consider this additional tax burden.

Federal Antitrust Laws

The NICPA subjects federally licensed insurers and insurance producers to the federal antitrust laws, thus carving back the limited insurance antitrust protection contained in the McCarran-Ferguson Act. The NICPA, however, eliminates regulatory involvement in determining rates because it provides that the Commissioner may not require a national insurer to use any particular rate, rating element, or price. Consequently, national insurers must be prepared to operate within the boundaries of federal antitrust laws with respect to rates and pricing as is currently the case in Illinois. The NICPA does, however, provide that national insurers, insurance agencies and producers would still be exempt from these antitrust laws in the development, dissemination, or use of standard insurance policy forms.

Future of NICPA

We continue to believe that the support and opposition to the NICPA will line up in a similar manner to the 2006 NIA and 2007 NIA. AIG and the crisis in

the financial sector has increased the momentum for change to regulation of the financial services industry and the insurance industry is no exception. In his March 26, 2009 testimony before the House Committee on Financial Services, the Treasury Secretary identified systemic risk regulation as only the first of four broad components of comprehensive regulatory reform of financial services. It will not be clear how the NICPA fits into the Treasury Department's overall plan for regulatory reform until the Treasury Department provides more details on its proposals, and until that time we do not expect the NICPA to gain much legislative traction. Locke Lord Bissell & Liddell LLP will continue to be involved in following and tracking all developments in this fast moving area.

About the Authors

John Gurley is a senior partner at LLB&L in our internationally known insurance law practice. Mr. Gurley has extensive experience in all areas of corporate insurance, his area of concentration for more than 30 years. He has been involved in the organization of numerous insurance companies and handled a considerable number of indemnity and assumption reinsurance transactions and insurance company acquisitions and sales.

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