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**MEMORANDUM**

November 12, 2009

Re: Dodd Regulatory Reform Legislation & Insurance Proposals

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On Tuesday, Senate Banking Committee Chairman Chris Dodd (D-CT) issued his financial regulatory reform proposal. The Dodd proposal contains insurance and consumer protection reforms that are similar to House and Administration proposals. This memorandum discusses the provisions in the Dodd bill that affect insurance reform and that create a Consumer Financial Protection Agency (CFPA). It also discusses how those proposals differ from legislation under consideration in the House.

**I. Insurance Reforms**

**i.) Establishment of Office of National Insurance**

The Dodd proposal would create an Office of National Insurance (ONI) within the Department of the Treasury. This new office, which largely mirrors the ONI created by House legislation (H.R. 2609) introduced by Rep. Paul Kanjorski (D-PA), would be headed by a Director, appointed by the Secretary of the Treasury. The ONI would be authorized to:

- Monitor all aspects of the insurance industry, including identifying issues or gaps in the regulation of insurers that create systemic risk;
- Recommend that the financial stability advisory agency created by the Dodd legislation designate a particular insurer – including the affiliates of such an insurer – as subject to heightened scrutiny and regulation due to the risks they pose;
- Assist the Secretary with administering the Terrorism Insurance Program;
- Coordinate federal policy on international insurance matters and represent the United States, as appropriate in the negotiation of international insurance agreements; and
- Advise the Secretary on major domestic and international insurance policy issues.

The legislation contains some limited preemption powers for the ONI. The Office could preempt state insurance laws that conflict with international insurance agreements and result in the less-favorable treatment of a non-United States domiciled insurer than a state domiciled insurer. Such preemption decisions are to be conducted through a notice and comment process.

The ONI is given the authority to receive and collect data and information from the insurance industry and individual insurers that is reasonably required to carry out its regulatory and advisory functions. This is to be done via information-sharing agreements;

though, if necessary, the Office would have subpoena authority. Insurers that are below a minimum size that the Office will establish, and affiliates of such insurers, are exempt from these information and data reporting requirements. The ONI will analyze and disseminate the information that is received and issue reports regarding all lines of insurance, except health insurance.

One significant difference between the Dodd proposal and the House legislation is Sen. Dodd's directive that the Office conduct a study and report on the insurance industry within eighteen months of the law's enactment. That study would focus on ways to modernize and improve U.S. insurance regulation. The ONI would be directed to consider the following issues in its study and report:

- Systemic risk regulation in the insurance sector;
- Capital standards and the relationship between capital allocation and liabilities, including standards relating to liquidity and duration risk;
- Consumer protection for insurance products and practices, including regulatory gaps in state regulation;
- The degree of national uniformity of state insurance regulation;
- The regulation of insurance companies and affiliates on a consolidated basis; and
- International coordination of insurance regulation.

The legislation also directs ONI to examine additional factors pertinent to the Federal regulation of insurance. Those factors are:

- The costs and benefits of potential Federal regulation of insurance across various lines of insurance, excluding health insurance;
- The feasibility of regulating certain lines of insurance at the Federal level, while leaving other lines of insurance to be regulated at the State level;
- The ability of any potential Federal regulation or Federal regulators to eliminate or minimize regulatory arbitrage;
- The impact that developments in the regulation of insurance in foreign jurisdictions might have on the potential Federal regulation of insurance;
- The ability of any potential Federal regulation or Federal regulator to provide robust consumer protection for policyholders; and
- Any other factors the ONI deems appropriate.

This study could be an important step towards getting Congress to adopt the optional Federal charter legislative proposal.

## **ii.) Nonadmitted Insurance and Reinsurance Regulation Reform**

Sen. Dodd's legislation incorporates reforms to the regulation of nonadmitted insurance (also known as "surplus lines") and reinsurance that passed the House earlier this year. The surplus lines and reinsurance reforms mirror those in H.R. 2571 and those proposed in the Senate by Senators Evan Bayh (D-IN), Bill Nelson (D-FL), and Mike Crapo (R-ID) (S. 1363).

### **a. Nonadmitted Insurance**

Concerning surplus lines reform, the legislation would prohibit any state other than the home state of an insured from requiring a premium tax payment for non-admitted insurance. States would be permitted to establish procedures to allocate among themselves the premium taxes paid to an insured's home state and would require surplus lines brokers and certain insureds to file annual tax-allocation reports.

Only an insured's home state would be allowed to require a surplus lines broker to be licensed to conduct non-admitted insurance business and to require a broker to provide certain financial information; other states would be prohibited from collecting fees relating to licensure. A state would be prohibited from charging any fees relating to licensing of an individual or entity as a surplus lines broker unless that state has adopted laws or regulations that provide for participation by the state in the National Association of Insurance Commissioner's (NAIC) insurance producer database. The Dodd proposal also eliminates the three-declination requirement that currently must be met before it is permissible to access the surplus lines market.

The legislation directs the Government Accountability Office (GAO) to conduct a study of the nonadmitted insurance market to determine the effect of the enactment of these surplus lines reforms on the size and market share of the nonadmitted insurance market for providing coverage typically provided by the admitted insurance market. The GAO study is to determine and analyze:

- The change in size and market share of the nonadmitted insurance market and in the number of insurance companies and insurance holding companies providing such business in the 18-month period after the reforms become effective;
- The extent to which insurance coverages typically provided by the admitted insurance market has shifted to the nonadmitted insurance market;
- The consequences of any change in the size and market share of the nonadmitted insurance market, including differences in price and availability of coverage in both the admitted and nonadmitted insurance markets;
- The extent to which insurance companies and insurance holding companies that provide both admitted and nonadmitted insurance have experienced shifts in the volume of business between admitted and nonadmitted insurance; and
- The extent to which there has been a change in the number of individuals who have nonadmitted insurance policies, the type of coverage provided under such

policies, and whether such coverage is available in the admitted insurance market.

During the course of the study, the GAO is directed to consult with the NAIC.

### **b. Reinsurance**

The reforms included in the Dodd proposal would prohibit a state from denying credit for reinsurance if the state of domicile of an insurer purchasing reinsurance (ceding insurer) recognizes credit for reinsurance for the insured's ceded risk, and the state is either an NAIC-accredited state or has financial solvency requirements substantially similar to NAIC accreditation requirements.

The proposal would reserve to the state of domicile of a reinsurer sole responsibility for regulating the reinsurer's financial solvency, so long as the state is NAIC-accredited or has financial solvency requirements substantially similar to the NAIC. A non-domiciliary state would be prohibited from requiring a reinsurer to provide financial information other than that required to be filed with the insurer's NAIC-compliant domiciliary state.

## **II. Consumer Financial Protection Agency**

The Dodd bill would create a Consumer Financial Protection Agency (CFPA) that is similar to that proposed by the Obama Administration and in the House. A comprehensive summary of the House Financial Services Committee iteration (H.R. 3126), was provided to you on October 28<sup>th</sup>. Like its House counterparts, the Dodd proposal would apply to debt cancellation products. The Dodd bill, however, does not contain an exemption for all insurance products; mortgage, title, and credit insurance offerings are not exempt from the agency's jurisdiction.

There are three other significant differences between the Dodd CFPA provisions and the CFPA legislation passed out of the House Financial Services Committee.

First, the Dodd proposal creates a five-member Board of Directors to govern the CFPA. That Board would be composed of four individuals nominated by the President and subject to Senate confirmation and the director of the Financial Institutions Regulatory Authority (FIRA) – the consolidated financial institution regulator created in the Dodd legislation. One of the appointed members would be designated as the Director by the President. This provision is similar to the version of the CFPA passed by the House Energy and Commerce Committee, but differs from the House Financial Services Committee version that has only one Director of the agency, as opposed to a board.

Second, the Dodd proposal differs from those versions in the House concerning CFPA examination authority. Dodd's legislation would permit the CFPA to examine all depository institutions that offer covered products. The House versions give primary examination authority to the primary banking regulators for all depository institutions with less than \$10 billion in assets.

The third difference concerns preemption authority. Under the House Financial Services Committee bill, national banks and Federal thrifts would have to comply with a state law unless it is preempted. A state law would be preempted only if it has a discriminatory

effect on a national bank or a Federal thrift; the OCC or the OTS determines that a state law “prevents or significantly interferes with” a national bank or Federal thrift’s exercise of its powers (similar to, but not as broad as, the *Barnett Bank* standard); or the state law is preempted by a Federal law other than the National Bank Act or the Home Owners Loan Act. In making a preemption determination, a court could not give deference to a determination of the OCC or the OTS.

The Dodd bill **does not** adopt the *Barnett Bank* standard; there is no preemption of a state law unless it discriminates against a national bank or Federal thrift, or if it is “inconsistent” with other Federal law. However, a state law is not “inconsistent” with Federal law if the CFPB determines that it provides consumers more protection than the Federal law.

Both bills would overturn *Watters v. Wachovia*, so that operating subsidiaries of national banks and Federal thrifts would be subject to state laws. They also would codify *Cuomo v. Clearing House*, which held that states have the right to enforce state laws against national banks and federal savings associations, but they have no visitation rights.