

IMPACT OF THE DODD-FRANK ACT ON THE INSURANCE INDUSTRY

After much debate and discussion, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act") has been signed into law by President Obama. Although the Act is often discussed as a means to overhaul the regulation of financial institutions, it contains a number of provisions which will directly impact the insurance industry. Such provisions are briefly discussed below.

Establishment of a Federal Insurance Office

The Act establishes a Federal Insurance Office (the "Office") within the Department of the Treasury. The Office is granted the authority to, among other things: (1) monitor all aspects of the insurance industry, including identifying issues or gaps in the regulation of insurers, (2) monitor the extent to which traditionally underserved communities and consumers, minorities and low and moderate-income persons have access to affordable coverage, (3) recommend designation of an insurer or any of its affiliates as an entity subject to regulation pursuant to the Restoring American Financial Stability Act of 2010, (4) coordinate federal efforts and develop federal policy with respect to international insurance matters, (5) consult with states and state insurance regulators regarding insurance matters of national and international importance and (6) perform related duties and have further authorities as may be assigned to it by the Secretary of the Treasury. Significantly, it appears that without further action, the Office will not have any authority with respect to health insurance, long-term care insurance (except such insurance that is included with life or annuity insurance components) or crop insurance. To carry out its duties, the Office will have broad authority to gather information from various parties, including insurers and their affiliates, although it is expected to attempt to coordinate with other federal agencies and state insurance regulators beforehand to determine if the information to be collected is available from, and may be obtained in a timely manner by, such other sources.

Significantly, the Act also provides that, no later than 18 months after the Office is established, the Office is expected to conduct a study and submit a report to Congress on how to modernize and improve the system of insurance regulation in the United States. Among other things, the study and report is expected to examine the costs and benefits of regulating certain lines of insurance at the federal level. This provision appears to leave the door open to further, more pervasive regulation of the insurance industry.

State-Based Insurance Reform

Subtitle B of Title V of the Act, which is generally effective one year from the enactment of the subtitle, contains provisions designed to resolve conflicting state laws relating to the regulation of surplus lines insurance and reinsurance.

Surplus Lines Insurance

Part I generally provides:

- The placement of surplus lines insurance shall be subject solely to the statutory and regulatory requirements of the insured's home state, except with respect to certain workers' compensation coverages.
- No state other than an insured's home state may require a surplus lines broker to be licensed in order to sell, solicit or negotiate surplus lines insurance. "Home state" is defined in the Act as: (1) the state in which an insured maintains its principal place of business or, in the case of an individual, the individual's principal residence or (2) if 100% of the insured risk is located out of state in which the principal place of business or principal residence is located, the state to which the greatest percentage of the insured's taxable premium for that insurance is allocated. States may enter into a compact or otherwise establish procedures to allocate among the states the premium taxes paid to an insured's home state.
- No state other than the home state of an insured may require any premium tax payment for surplus lines insurance.
- A state may only impose upon surplus lines insurers domiciled in the U.S. those eligibility standards established by the National Association of Insurance Commissioners (the "NAIC") in the Non-Admitted Insurance Model Act.
- With respect to the licensure of surplus lines brokers and the renewal of such licenses, states must participate in the National Insurance Producer Database of the NAIC within two years after the subtitle is enacted or will otherwise not be eligible to collect fees.
- A state may not prohibit a surplus lines broker from placing business with a non-United States insurer included on the NAIC Quarterly List of Alien Insurers.
- A state may not require that a surplus lines broker undertake a diligent search to determine whether coverage can be obtained from admitted insurers for "exempt commercial purchasers" (defined in the Act) if the surplus lines broker has complied with certain disclosure requirements and has obtained a subsequent prior written request from the exempt commercial purchaser to procure or place such insurance from a non-admitted insurer.

Reinsurance

Part II of the Act (relating to reinsurance) provides that if the state of domicile of a ceding insurer is: (1) an NAIC-accredited state or has financial solvency requirements substantially similar to the requirements necessary for NAIC accreditation, and (2) recognizes credit for reinsurance for the insurer's ceded risk, no other state may deny credit for reinsurance. In addition, Part II provides that all laws, regulations and other actions of a state that is not the state of domicile for a ceding insurer (except those relating to taxes and assessments) are preempted to the extent they: (1) restrict or eliminate the rights of the ceding or assuming insurer to resolve disputes pursuant to contractual arbitration, (2) require that a certain state's

laws shall govern a reinsurance contract and related disputes and requirements, (3) attempt to enforce a reinsurance contract on terms other than those set forth in the contract or (4) otherwise apply the laws of the state to reinsurance agreements of ceding insurers not domiciled in that state. Moreover, the Act provides that if the state of domicile of a reinsurer is NAIC accredited, such state shall be solely responsible for regulating the financial solvency of such reinsurer.

We will not know the full impact of the Act for some time, given that it will take time for its provisions to be fully implemented, interpreted and enforced. The insurance industry will need to carefully watch federal activities relating to such Act to ensure that any adverse consequences are avoided and/or minimized.

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