The Rise And Fall Of The Federal Insurance Office

Law360, New York (January 19, 2010) -- Suggestions for increased federal control over the insurance business have periodically surfaced, but on each such occasion defenders of state-based regulation have prevailed against the challenge.

As the financial crisis intensified from mid-2008 forward, the system of state-based regulation appeared more vulnerable than ever before, and dramatic change in the landscape of financial regulation was predicted.

Many of these ambitions were centered on a new federal entity to regulate insurers, encompassing the negotiation of international agreements, a role in consumer protection, and even the issuance of federal insurance charters, optional or mandatory.

The impetus for the most recent surge came from the credit crisis that began in 2007. Although most insurance companies fared far better than other financial institutions, in part due to the state-based regulatory scheme and the state guaranty funds, AIG’s high-profile role, with reports that its credit default swaps might threaten the stability of the global financial system and the consequent government rescue, drew insurance into the limelight.

The separate regulatory regimes governing financial services companies were viewed as the culprits for allowing the credit bubble to grow unchecked — and this fear of contagion or systemic risk was expanded to encompass insurance, which was perceived to harbor possible systemic risk that had to be brought under central oversight and regulation.

It now appears that the drive for radical financial reform has crested without reaching its objective, and that insurance reform, if it comes, will be mild.

This article traces the demise of the movement by tracking the trajectory of the proposals relating to the new federal entity — an "Office of National Insurance" or
"Federal Insurance Office" — which may yet come to exist as a formal agency, but which will have been stripped of meaningful power and authority.


Just as the highly-charged political environment after 9-11 ensured passage of the USA Patriot Act, which gave federal authorities a broad range of enforcement powers they had long coveted, the perception of an existential threat to the financial system led proponents of insurance reform to think that the credit crisis would offer a chance to pursue major changes — including creation of an entity which would serve as a "single voice" for the U.S. for international agreements, expansion of federal consumer protection measures relating to insurance, and implementation of the long-discussed federal charter for insurance companies.

In 2008, Democratic Rep. Paul Kanjorski of Pennsylania, head of the House Financial Services Subcommittee, filed an ambitious reform proposal which was withdrawn for lack of support.

As the financial crisis began to bite more deeply, Rep. Kanjorski submitted, in May of last year, the Insurance Information Act of 2009 (HR 2609), parts of which influenced the administration’s June White Paper on financial reform (discussed below)

NICPA and the Optional Federal Charter

The proposal for an optional federal charter for insurance companies was best articulated in the National Insurance Consumer Protection Act, introduced in April of 2009 as HR 1889 by Representatives Melissa Bean and Ed Royce.

As its title indicates, NICPA places considerable emphasis on extensive consumer protection provisions, which would fall within the purview of the federal insurance regulator.

NICPA would create an “Office of National Insurance” with a commissioner appointed by the president. Although the ONI would be formed within the Treasury Department, and there would be general oversight by the Secretary, the ONI would have a degree of independence comparable to that of the federal bank regulators also formed within Treasury.

Its supervisory responsibility would extend to life insurance companies, property and casualty insurers, insurance producers, and agents and brokers. The office would directly regulate federally chartered insurers and would also serve as a systemic risk regulator for state-chartered companies.

The ONI’s enforcement powers would be modeled on those of federal bank regulators, and it would have specific authority to override state regulators. Some state law would
still apply to insurers under the ONI’s purview, and it would be charged to “take into consideration” NAIC model laws.

Rep. Barney Frank, D-Mass., has said that he intends to bring NICPA back before the House early in 2010.

The White Paper: Gathering Momentum


Citing AIG, the White Paper proposed establishment of the ONI within Treasury as the keystone of a program to provide early warning of systemic financial hazards and to gather information, develop federal expertise, coordinate federal policy, and negotiate international agreements relating to the insurance sector.

Functions-related systemic risk monitoring would include identifying gaps in regulation that could lead to another crisis, and being prepared to recommend to the Federal Reserve any insurer the ONI believed should be supervised as a “Tier 1 Financial Holding Company.”

Critical to the White Paper’s analysis was the perceived need for a new central body to represent the U.S. in connection with international agreements and multinational conventions.

The WP asserted that lack of a centralized federal entity had hampered U.S. effectiveness in “engaging internationally,” noting that the U.S. is the only country not represented in the International Association of Insurance Supervisors by an entity “able to speak with one voice.”

Specifically noted was EU legislation (the insurance directives) that will require a foreign insurer operating in an EU member state to be subject to supervision in its own country “comparable to that the supervision required in the EU.” The WP argued that the ONI would “expand opportunities for the [U.S.] insurance industry to export its services.”

Raising a highly controversial issues, the WP also discussed the prevention of “gaps” in consumer protection under the present system, a phenomenon attributed by the WP to varying levels of protection among the states.

This suggestion, and related proposals in pending reform bills, not surprisingly, produced strong opposition from state insurance commissioners and others who assert that the states are best positioned to protect the consumers within their boundaries, an argument supported by the strength of the state insurance guaranty funds and the track record of states in resolving insurance company insolvencies quickly and efficiently.
The WP also raised the suggestion of a possible federal insurance charter. The WP’s precise phrasing — “either a federal charter or effective action by the states” — is thought to have been carefully calibrated, with the word “optional” prominently missing before “federal charter” as a warning shot to state regulators: Either get your house in order through uniform regulations, or face the prospect of a non-optional federal charter.

The Federal Insurance Office Act of 2009 — At the Crest of the Wave

By the late summer and fall of 2009, the press was predicting that public and political anger would surely lead to a radically altered regulatory landscape for financial firms, including insurers.

In October, Congressman Kanjorski filed as a “discussion draft” an amendment to his earlier bill, HR 2609. The “The Federal Insurance Office Act of 2009” had as its focus the creation of a new “Federal Insurance Office,” housed in Treasury, and would apply to most forms of insurance other than health.

The draft bill would not have limited any provision of Rep. Barney Frank’s proposed “Consumer Financial Protection Agency Act of 2009” (HR 3126), now a key element of the reform bill passed by the House in December 2009.

In its original form, the CFPA would have extended federal authority over some consumer protection matters arising in the insurance context. Subsequent markups to the CFPA added an exclusion for all persons “subject to regulation by any State insurance regulator.”

The FIO would have authority to negotiate and enter into international agreements on prudential matters, and it would also have the authority to preempt state insurance law and regulation to the extent state measures were inconsistent with such agreements.

Under the original (and current) proposed language, once the required procedure had run its course, “[N]o state may enforce a State insurance measure to the extent that it has been preempted under this subsection.”

(The bill did not contemplate giving the director authority to preempt state measures relating to rates, premiums, underwriting requirements, or the application of state antitrust laws.)

The preemption provisions came under heavy attack from state insurance regulators and the National Association of Insurance Commissioners, including a widely circulated letter from the NAIC to all members of Congress.

The Tide Goes Out

The collapse, when it came, was swift. In a markup session on or about Nov. 17, the House Financial Services Committee amended the FIO Act to remove authorization for
the office to enter into international agreements, to require close between the office and the states before any such agreements are entered into (by the Secretary and U.S. Trade Representative), to limit potential preemption of state insurance measures, and to generally reaffirm the authority of the states over the insurance business.

The provisions of the FIO Act as so amended were included in The Wall Street Reform and Consumer Protection Act passed by the House as HR 4173 on Dec. 11.

**Senator Dodd’s Proposal — Grand Ambition, Uncertain Prospects**

Weighing in at over a thousand pages, the Restoring American Financial Stability Act of 2009, filed by Senate Banking Committee Chairman Chris Dodd, D-Conn., in November 2009, would effect a drastic overhaul of the financial regulatory system. Insurance takes up less than 20 pages of the bill, which has been criticized by the head of the American Insurance Association as “bank-centric.”

The omnibus proposal includes a “Office of National Insurance Act of 2009” which would create within Treasury an ONI, to be headed by a director appointed by the Treasury Secretary. The office would monitor the insurance industry to identify issues and “gaps,” and it would have the power to designate an insurer as “specified financial company” for enhanced monitoring of possible systemic risk.

The ONI proposed by the Dodd bill would help to coordinate federal policy on prudential aspects of international insurance matters, including representation of the U.S. in the International Association of Insurance Supervisors, but would not have authority to enter into agreements.

It would have the power, in theory, to preempt state insurance measures inconsistent with an international insurance agreement on prudential measures, after notice to the state in question and to specified House and Senate committees.

The AIA has expressed concern that the insurance regulatory system envisioned by the Dodd proposals would not be sufficiently authoritative to be deemed “equivalent” for purposes of EU insurance provisions.

As for the bill's general prospects for passage, Sen. Dodd's retirement may either enhance its chances of success (as the New York Times has speculated) or reduce them.

The latter scenario places great weight on possible hesitance over the makeup of the Senate and critical committees after the mid-term elections and the administration’s diminishing store of political capital to support major reforms.

If final legislation is enacted this year, then the surviving provisions of the Rep. Kanjorski's FIO Act now contained in HR 4173 will have to be reconciled with the minimalist insurance provisions of the Dodd bill.
There is no support for another run at fundamental insurance reform in the current climate, and if or when there are markups to reconcile the House and Senate bills, the likely outcome will be toward more cutting of any inconsistent provisions, leaving perhaps an information-gathering FIO or ONI, without meaningful authority despite those in the insurance industry who would favor an expanded role for an FIO.

In sum, after a rousing start, the drive for radical reform of the insurance regulatory landscape appears to have once again foundered, leaving the defenders of state primacy in possession of the field.

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