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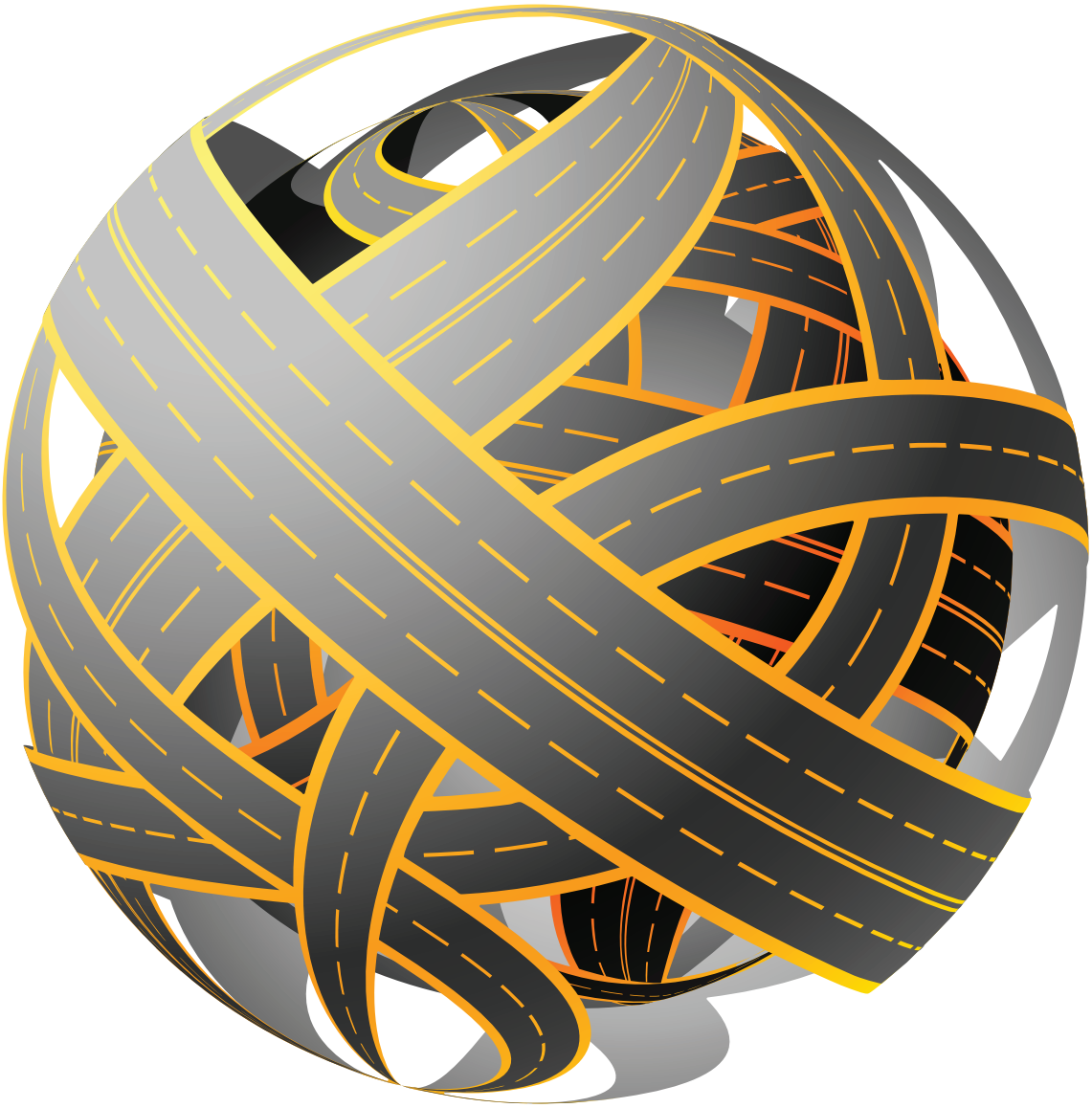

Regulatory outlook for insurance

Following House passage of CHOICE, where do insurance reforms stand?

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Introduction

What's next for insurance company regulation?

Both the executive and legislative branches of government have begun the process of making significant changes to the existing financial services regulatory framework, including the laws and regulations applicable to insurance companies. These changes primarily target new or increased regulatory powers enabled by the Dodd-Frank Act (Dodd-Frank).

In April 2017, President Donald Trump issued a directive to the Treasury Secretary to review aspects of Dodd-Frank—including the Orderly Liquidation Authority[1] and the Financial Stability Oversight Council's (FSOC) systemically important financial institution (SIFI) designation process.[2] More recently, on June 8, 2017, the US House of Representatives passed the Financial CHOICE Act of 2017. Nonetheless, which reforms—if any—survive the legislative process, how far any changes will go, how fast they may happen, and how much they will affect insurers remains unclear because a number of legislative and regulatory hurdles persist.

House Financial Services Committee Chairman Jeb Hensarling (R-TX) has said that Dodd-Frank "has been a greater burden to enterprise than all other Obama-era regulations combined."[3] With the House's passage of CHOICE, Chairman Hensarling is one step closer to his expressed intent to repeal and replace major components of the law, including the authority of the FSOC to designate nonbank financial institutions, such as insurance companies, as SIFIs.

While the Senate has yet to advance reform legislation, Senate Banking Chairman Mike Crapo (R-ID) has signaled his intention to work in a bipartisan fashion, which is likely to result in a different reform package than that passed by the House.

Certain changes, however, may be enacted within the confines of the current statutory framework, such as a rescission of the existing SIFI designations and a decision by Treasury Secretary Steven Mnuchin, in his capacity as FSOC Chair, not to issue additional designations during President Trump's term. These changes would be more limited in scope than those contemplated by new legislation and may not outlast this administration's term in office.

Perhaps most importantly, even if there are changes at the federal level, insurance companies are primarily regulated and supervised at the state level. State insurance regulators often note that they regulate the insurance industry in the US, and many states will maintain—or perhaps even enhance—their current supervisory and enforcement regimes. As one example, Maria Vullo, Superintendent of New York State's Department of Financial Services, has reiterated her commitment to taking an aggressive approach to enforcement against regulated institutions, including insurance companies.[4]

Although it remains much too early to definitively predict how the regulatory framework may change under the Trump Administration, it's worthwhile for insurance companies to understand some of the leading reform proposals. This paper will discuss legislative proposals and changes proposed by the Administration that may impact the insurance industry.

[1] White House, "Presidential Memorandum for the Secretary of the Treasury," (April 21, 2017), available at https://www.whitehouse.gov/the-press-office/2017/04/21/presidential-memorandum-secretary-treasury-0.
[2] White House, "Presidential Memorandum for the Secretary of the Treasury," (April 21, 2017), available at https://www.whitehouse.gov/the-press-office/2017/04/21/presidential-memorandum-secretary-treasury.
[3] House Financial Services Committee, "Hensarling: America has struggled for too long," (April 26, 2017), available at http://financialservices.house.gov/news/documentsingle.aspx?DocumentID=401822.
[4] Law360, "State Regulators Aim To Fill Trump's Vacuum," (November 18, 2016), available at https://www.law360.com/articles/864201/state-regulators-aim-to-fill-trump-s-vacuum.

Leading legislative proposal: Financial CHOICE Act

The CHOICE Act may be the most extensive financial regulatory reform legislative proposal advanced during the 115th Congress. Although the majority of analyses related to the CHOICE Act have focused on the bill's implications for large banking organizations, the legislation would establish important changes for insurance companies, particularly large insurers, as outlined in the following table.

Proposed changes to insurance regulatory framework in Financial CHOICE Act

Area	Current	Proposed change
Federal Insurance Office (FIO)	The FIO, an office within the Treasury Department, has the authority to: • Monitor all aspects of the insurance industry and identify issues or gaps in the regulation of insurance companies that could contribute to a systemic crisis in the insurance industry or US financial system • Monitor the extent to which traditionally underserved communities and consumers, minorities, and low- and moderate-income persons have access to affordable insurance products regarding all lines of insurance, except health insurance • Recommend that the FSOC designate an insurer for enhanced supervision and regulation • Coordinate federal efforts and develop federal policy on prudential aspects of international insurance matters, including representing the US at the International Association of Insurance Supervisors (IAIS) • Determine whether state insurance measures are preempted by covered agreements • Consult with the states regarding insurance matters of national importance and prudential matters of international importance	The FIO would be abolished and the Office of the Independent Insurance Advocate would be established with the authority to: • Coordinate federal efforts on prudential aspects of international insurance matters • Consult with the states regarding insurance matters of national importance • Assist the Treasury Secretary in administering the Terrorism Reinsurance Program • Observe all aspects of the insurance industry and identify issues that could contribute to systemic crises in the insurance industry or the US financial system
FSOC independent member	The president shall nominate an independent, voting member of the FSOC with insurance expertise, who shall serve for a term of six years after being confirmed by the Senate.	The independent member would be replaced by the Independent Insurance Advocate as a voting member of the FSOC. Similar to the independent member, the Independent Insurance Advocate would be nominated by the president and confirmed by the Senate.

Proposed changes to insurance regulatory framework in Financial CHOICE Act		
Area	**Current**	**Proposed change**
FSOC nonbank SIFI designation process	The FSOC has the authority to designate a nonbank financial company for enhanced supervision and regulation by the Federal Reserve Board (FRB) if it determines that material financial distress at the company—or the company's nature, scope, size, scale, concentration, interconnectedness, or mix of activities—could pose a threat to US financial stability.	The FSOC's authority to designate nonbank financial companies for enhanced supervision and regulation would be retroactively repealed.
Treatment of covered agreements	The Treasury Secretary and US Trade Representative (USTR) are authorized to negotiate and enter into covered agreements on behalf of the US.	The Treasury Secretary and the USTR would be required to publish in the Federal Register and make available for public comment the proposed text of a bilateral or multilateral agreement regarding prudential measures relating to insurance or reinsurance before the agreement can become effective.
Other international agreements	The Treasury Department may participate in international insurance standard-setting processes, such as the IAIS and Financial Stability Board (FSB).	The Treasury Department would be required to notify Congress and the public before participating in international standard-setting processes, publicly report on such processes, and notify the House Financial Services Committee and the Senate Banking Committee of agreements that may result from such processes (and consult with the committees on the agreements and their economic effects).

While the Senate is unlikely to pass the CHOICE Act in its current form, it remains important that insurance companies—especially internationally active insurance groups that may be affected by international agreements—carefully analyze the bill and understand how they would be impacted by these changes.

Additional past and pending insurance legislation

In addition to the insurance-related provisions of the CHOICE Act, it remains possible that Congress will consider standalone legislation that would affect the insurance industry.

Following the 2014 enactment of a bill[5] unanimously passed by the House and Senate to clarify the application of leverage and risk-based capital requirements to insurance companies under Section 171 of Dodd-Frank (the so-called "Collins Amendment"), there has been increasing bipartisan support for other insurance-related legislation.

In April 2017, Representative Sean Duffy (R-WI), Chairman of the House Financial Services Housing and Insurance Subcommittee, and Representative Denny Heck (D-WA) released[6] a discussion draft of a bill (the International Insurance Standards Act) that proposes to treat international insurance agreements and covered agreements as rules for the purposes of the Congressional Review Act.

In addition, the bill would, among other things:

- Require that state insurance regulators are included throughout the negotiations of covered agreements and international insurance agreements
- Enhance Congressional consultation and review of international insurance agreements
- Require that covered agreements not include new prudential requirements for US insurers

The comment deadline on the discussion draft ended on April 20, 2017, and Representatives Duffy and Heck are expected to formally introduce the bill in the near future.

In conjunction with this potential legislation, both the House Financial Services Committee and the Senate Banking Committee have held hearings on the US-European (EU) covered agreement[7] on prudential measures regarding insurance and reinsurance.

[5] S. 2270, the ("Insurance Capital Standards Clarification At of 2014"), available at https://www.congress.gov/113/plaws/publ279/PLAW-113publ279.pdf.
[6] Representative Sean Duffy, "Duffy and Heck Request Input on Bipartisan International Insurance Legislation," (April 7, 2017), available at https://duffy.house.gov/press-release/duffy-and-heck-request-input-on-bipartisan-international-insurance-legislation.
[7] US Department of the Treasury, "Bipartisan Agreement Between the European Union and the United States of America on Prudential Measures Regarding Insurance and Reinsurance," (January 13, 2017), available at https://www.treasury.gov/initiatives/fio/Documents/Final%20Covered%20Agreement%20Letters%20to%20Congress%20Full%20Text.pdf.

Potential shift at the FSOC

Even without new legislation, the Trump Administration has the ability to make certain changes to the insurance regulatory framework within the confines of the current statutory framework.

On April 21, 2017, President Trump issued a memorandum directing Secretary Mnuchin to conduct a thorough review of the FSOC's processes for making nonbank SIFI designations and provide a report to the President within 180 days considering, among other things, whether this process:

- Is "sufficiently transparent"
- Provides entities with "adequate due process"
- Gives market participants the expectation that the federal government will "shield supervised or designated entities from bankruptcy"

After Secretary Mnuchin conducts this review, the memorandum directs him to issue recommendations on how the nonbank SIFI designation process could be improved, including by new legislation. The memorandum also holds that, except in cases of emergency, the FSOC should not issue any additional designations pending the completion of the review.

Although the report is not due until October 2017—and its conclusions certainly cannot yet be determined—the administration's decision to review this process signals that it believes the nonbank SIFI designation process may not comport with its "core principles" for regulating the US financial system.[8] For example, one day before President Trump signed his Executive Order setting forth the "core principles," National Economic Council Director Gary Cohn said, "[w]e don't think nonbanks should be SIFIs,"[9] indicating the possibility that the administration may seek to rescind the existing SIFI designations and opt not to issue additional designations during President Trump's term. Although this path would not preclude future administrations from imposing SIFI designations, it would mark a significant shift from the FSOC's practice under the Obama Administration and should be understood and monitored by large insurance companies.

In addition to reviewing the FSOC's nonbank SIFI designation process, Treasury Secretary Mnuchin is conducting a larger review of the financial regulatory framework pursuant to President Trump's executive order setting forth the administration's "core principles" for regulating the US financial system. Treasury issued its first report[10] on regulations governing depository institutions on June 12, 2017, and expects to issue three additional reports—including one focused specifically on the asset management and insurance industries—later in 2017. These reports will provide a detailed view of the administration's policy priorities, including possible regulatory changes.

[8] White House, "Presidential Executive Order on Core Principles for Regulating the United States Financial System," (February 3, 2017), available at https://www.whitehouse.gov/the-press-office/2017/02/03/presidential-executive-order-core-principles-regulating-united-states.
[9] Wall Street Journal, "Gary Cohn's Vision for a Regulatory Rethink," (February 3, 2017), available at https://www.wsj.com/articles/white-house-plans-broad-rethink-on-regulating-big-financial-firms-1486116003.
[10] US Department of the Treasury, "A Financial System That Creates Economic Opportunities: Banks and Credit Unions," Report to President Donald J. Trump, Executive Order 13772 on Core Principles for Regulating the United States Financial System," (June 12, 2017), available at https://www.treasury.gov/press-center/press-releases/Documents/A%20Financial%20System.pdf.

Future of the FRB's capital framework

In June 2016, the FRB issued an advance notice of proposed rulemaking (ANPR)[11] on separate capital requirements for (1) depository institution holding companies significantly engaged in insurance activities and (2) FSOC-designated nonbank financial companies that have significant insurance activities.

Even if the FSOC opts to rescind the existing SIFI designations, the FRB would retain the authority to proceed with a formal proposed rule for depository institution holding companies engaged in insurance activities. (If the FSOC does not rescind the existing designations, the FRB's potential proposed rule would be significant for those companies.)

For these holding companies, the ANPR contemplates a building-block approach that would use existing legal-entity capital requirements for insurance companies, including state and foreign insurance risk-based capital requirements, and the bank holding company or bank risk-based capital standards for banking, non-insurance, and unregulated entities. Accordingly, a company's aggregate capital requirements would generally be the sum of the capital requirements at each subsidiary.

It remains unclear how the FRB will choose to proceed with the ANPR initiative. The Trump Administration has taken several actions that, while not directly applicable to the FRB, have appreciably slowed the pace of new rules from the regulatory agencies.[12]

At the FRB specifically, there's a heightened political risk of advancing the rulemaking agenda before President Trump's nominees to the agency are confirmed. In February 2017, all 34 Republicans on the House Financial Services Committee—led by Chairman Hensarling—sent a letter to FRB Chair Janet Yellen arguing that, "[a]bsent an emergency, the [FRB] should neither propose nor adopt any new rules until the US Senate confirms a Vice Chairman for Supervision."[13] The letter warns that, if the FRB chooses to adopt rules prior to the confirmation of a Vice Chairman for Supervision, the lawmakers will work to "ensure that Congress scrutinizes the [FRB's] actions—and, if appropriate, overturn them—pursuant to the Congressional Review Act."

On July 10, 2017, President Trump announced his intent to nominate Randal Quarles, formerly Under Secretary for Domestic Finance in the George W. Bush Administration, as FRB Vice Chairman for Supervision.[14] His confirmation hearing before the Senate Banking Committee should provide useful insights for how the FRB will proceed on regulatory issues affecting insurance companies, including the capital-related ANPR.

[11] Federal Reserve System, "Capital Requirements for Supervised Institutions Significantly Engaged in Insurance Activities," Advance Notice of Proposed Rulemaking, 81 Fed. Reg. 38631, (June 14, 2016), available at https://www.gpo.gov/fdsys/pkg/FR-2016-06-14/pdf/2016-14004.pdf.
[12] See White House, "Memorandum for the Heads of Executive Departments and Agencies," (January 20, 2017), available at https://www.whitehouse.gov/the-press-office/2017/01/20/memorandum-heads-executive-departments-and-agencies and White House, "Presidential Executive Order on Reducing Regulation and Controlling Regulatory Costs," (January 30, 2017), available at https://www.whitehouse.gov/the-press-office/2017/01/30/presidential-executive-order-reducing-regulation-and-controlling.
[13] Letter from 34 Republicans on the House Financial Services Committee to Federal Reserve Board Chair Janet Yellen, (February 23, 2017).
[14] White House, "President Donald J. Trump Announces Key Additions to his Administration," (July 10, 2017), available at https://www.whitehouse.gov/the-press-office/2017/07/10/president-donald-j-trump-announces-key-additions-his-administration.

International developments

Another consideration for insurers is the continuing impact of worldwide insurance regulatory reform. The effects of this reform on US insurance regulation already include enhanced corporate governance disclosure requirements, the own risk and solvency assessment (ORSA), and the development of a group capital metric.

US insurers seeking growth internationally may have to consider the repercussions of any divergence between US and international regulatory requirements, as well as the consequences for mutual recognition of a US system that may not meet internationally agreed-upon standards for supervision of SIFIs and global systemically important insurers (G-SIIs).

At its 2017 summer meeting, the IAIS reinforced its continuing commitment to the development of insurance capital standards (ICS) and the Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame) despite concerns expressed by some US stakeholders, including NAIC President Ted Nickel. Speaking on a panel at the event, Nickel said that regulators needed to "get it together" and "get uniformity in something as simple as ORSA" before they try to implement ICS across jurisdictions.[15]

The IAIS also announced two work streams that potentially could have significant impacts. One work stream would create a dedicated resource to monitor technology developments and recommend an appropriate regulatory response, including data protection, privacy, and ownership. This is where a divergence between EU and US regulations may arise.

Organizations operating in the EU will be subject to the EU General Data Protection Regulation (GDPR) beginning May 25, 2018. The GDPR reflects European commitment to data privacy and individual data ownership, including the right to be forgotten.

It applies to organizations located within the EU as well as organizations located outside of the EU if they offer goods or services to, or monitor the behavior of, EU data subjects. It applies to all companies processing and holding the personal data of data subjects residing in the EU, regardless of the company's location. Organizations can be fined up to four percent of annual global turnover for breaching GDPR or €20 million, the EU has announced.

Another new work stream may increase the scope of coverage of macroprudential regulation designed to minimize and mitigate systemic risk. After having focused on entity-based regulation, the IAIS—working with the FSB—is now adding an activities-based lens to its systemic risk toolbox. That may mean smaller organizations that would not have been affected by entity-based systemic risk regulation may now face scrutiny.

[15] Deloitte.com, "IAIS 2017 Summer Update," Deloitte.com, (July 2017), available at https://www2.deloitte.com/us/en/pages/financial-services/articles/international-association-of-insurance-supervisors.html.

Conclusion

No matter the possible impact of new legislation and shifts in focus by regulators, insurance companies should maintain strong compliance and enterprise-wide risk management programs as they analyze the potential impact of such changes.

Especially given the commitment by several state regulators to maintain or enhance their supervisory and enforcement regimes for insurance companies, the industry would be wise not to conclude that a possible deregulatory shift at the federal level will result in a reduced regulatory burden overall. In preparing for regulatory reform, insurance companies may be wise to maintain a policy of proactive engagement in the legislative and regulatory arenas. Rigorous analysis of developments on the legislative front—such as the CHOICE Act—and on the regulatory front—such as designations of SIFIs and capital rules—should be combined with close monitoring and engagement with regulators and the regulatory approaches at the state and international levels.

In fact, insurers that embrace complexity in the regulatory environment, and learn to manage it, can use this to lead in the industry, navigate new regulatory changes, and even disrupt the marketplace.

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