CONSTITUTIONAL CONCERNS WITH THE REINSURANCE REGULATORY MODERNIZATION ACT

By John Pitblado

The National Association of Insurance Commissioners ("NAIC") proposed federal legislation, entitled the Reinsurance Regulatory Modernization Act ("RRMA"), an exposure draft of which was published and opened for comments on March 24, 2009. The comment period closed on April 23, 2009. The comments submitted from various industry groups reflect a number of concerns with the proposed legislation, including constitutional concerns about the delegation to NAIC of regulatory authority under the proposed law. This article will discuss the basic features of the draft RRMA, and the various concerns raised in response thereto by the comments, including a number of constitutional concerns.

The Exposure Draft RRMA

As reported more fully in a recent Special Focus article,[1] the broad purposes of the RRMA include the following:

- Establishing in the NAIC a Reinsurance Supervision Review Board ("RSRB")
- Establishing two new classes of reinsurers in the U.S.: "national reinsurers" (licensed and domiciled in a U.S. state) and "port of entry" ("POE") reinsurers (non U.S. reinsurers certified in a port of entry state in the U.S.), both regulated by a single U.S. supervising jurisdiction.
- The NAIC and RSRB would determine a state's eligibility as a POE state.
- Allowing ceding companies credit for national and POE reinsurance.
- Assigning financial strength ratings for national and POE reinsurers (and calculating required collateral based on RSRB developed-formulae).
- Preemption of inconsistent state laws
- "Consultation" with federal and state agencies "as necessary"

Several written comments were posted to the NAIC website during the comment period. The commenters included the American Council of Life Insurers ("ACLI"), the American

[1] *See* Cicchetti, Anthony, "Update on NAIC Reinsurance Collateral Proposals," *Reinsurancefocus.com* (April 20, 2009).

Insurance Association ("AIA"), Allstate Insurance Company ("Allstate"), CEA Insurers of Europe ("CEA"), the Financial Services Authority ("FSA"), Hannover Rückversicherung AG ("Hannover Re"), the International Underwriters Association of London ("IUA"), Lloyd's America, Inc. ("Lloyd's"), Property Casualty Insurers Association of America ("PCI"), the Reinsurance Association of America ("RAA"), State Farm Mutual Automobile Insurance Company ("State Farm"), Tawa Management, Ltd. ("Tawa"), and the W.R. Berkeley Corporation ("W.R. Berkeley").[2]

Most of the comments note problems either with the proposed bill generally, with specific provisions, or with particular drafting language (and in some cases, all of the above). At the level of general concerns, ACLI's comment indicated disfavor with the entire concept of creating a non-governmental board with no oversight, rather than a federal-level government agency, and merely for the narrow purpose of regulating capital and surplus requirements, rather than dealing with the regulation of reinsurance more generally.

This sentiment is shared in comments submitted by the RAA. In both its comments, and in recent testimony provided by the President of the RAA, Franklin Nutter, to the U.S. House Subcommittee on Capital Markets, Insurance and Government Enterprises, RAA voiced strong support for the creation of a federal agency, in lieu of the patchwork of state regulation under the onerous NAIC model law enactment process. The RAA's comments reveal concern for a competitive imbalance in the global reinsurance market without a centralized regulatory authority in the U.S., as new reinsurers entering the market have been forming mainly in non-U.S. jurisdictions, ostensibly in avoidance of the cumbersome state-by-state regulatory approval process. On the other side of the same coin, the FSA, IUA, Lloyds and Hannover Re have noted that, from the European perspective, the lack of a single federal regulatory body from the U.S. creates difficulties for foreign reinsurers in navigating the U.S. market. Aspects of both types of concern over a lack of federal authority are also generally reflected in various comments about the proposed bill's constitutionality.

Practical Considerations

On the practical level, multiple comments note that the bill lacks confidentiality protections. For example, the IUA noted that Section 2c of the proposed bill, providing for the development of regulatory cooperation agreements, could lead to disclosures to U.S. regulators that are required to be maintained in confidence, but that could nonetheless become subject to state freedom of information laws. State Farm suggested a carve-out of capital requirements for affiliate reinsurance transactions, which, according to the comment, already have adequate oversight by ceding companies' domestic regulators, and which transactions are separately reviewed prior to implementation by those regulators, and should therefore not be subject to additional requirements under the proposed bill. The PCIA suggested the bill will create

[2] The draft legislation and comments are posted on the NAIC website (available at: http://www.naic.org/committees_e_reinsurance.htm).

solvency risks for domestic ceding companies doing business with foreign reinsurers, where the capital requirements do not require collateral (a sentiment shared and expressed by Allstate).

Unsurprisingly, the various European entities' comments – including the CEA, FSA, IUA and Lloyd's – generally reflect a concern for bias in the proposed bill in favor of domestic reinsurers, insofar as the collateral requirements "unfairly discriminate" (the CEA's words) against POE reinsurers.

Constitutional deficiencies

The most interesting comments, however, are the various, and often detailed, concerns with the exposure draft's constitutionality. The noted defects include a potential conflict with the Appointments Clause, U.S. Const. Art. II §2, which reserves authority for the appointment and consent of officers of the United States to Congress and the President (as opposed to a non-governmental corporate board appointed by a trade association). The draft potentially also conflicts with the Tenth Amendment, insofar as it purports to allow for federal preemption of states' rights. More than one comment construed the lack of any review process as potentially violative of due process rights under the Fifth and Fourteenth Amendments. ACLI suggested that the evaluation process outlined in Section 7(c) is "unconstitutionally vague." Finally, Lloyd's was kind enough to point out that, in the least impolitic manner possible, that, given the several perceived constitutional deficiences, "NAIC may wish to take counsel on these issues if it has not already done so."

At any rate, the NAIC has taken the comments under advisement. At its summer 2009 meeting, the comments were discussed, and the bill has been put on hold while NAIC obtains an outside legal opinion concerning the various constitutional defects raised in the comments. Reinsurancefocus.com will continue to track the progress of the RRMA.

This article does not constitute legal or other professional advice or service by JORDEN BURT LLP and/or its attorneys. For further information, contact the author, John Pitblado, at (860) 392-5000.