CARLTON FIELDS

U.S. Treasury Department Releases Report Which May Provide a Preview of the Trump Administration's Agenda for the Regulation of the Insurance Industry

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On October 26, 2017, the U.S. Department of the Treasury has released a report entitled "A Financial System that Creates Economic Opportunities: Asset Management and Insurance" (the "Report").[1] The Report is the third of four reports to be issued by the Treasury in response to Executive Order 13772[2] of February 3, 2017. The Executive Order states that the reports are to discuss the extent to which existing laws, treaties, regulations, guidance, reporting, and recordkeeping requirements, and other Government policies promote the Core Principles, and what actions have been taken, and are currently being taken, to promote and support the Core Principles. That report, and all subsequent reports, shall identify any laws, treaties, regulations, guidance, reporting, and recordkeeping requirements, and other Government policies, that inhibit Federal regulation of the United States financial system in a manner consistent with the Core Principles.[3] The reports are envisioned to provide a work plan and policy guidance for both legislative and executive agency action with respect to specific industries. This Report discusses the asset management[4] and insurance industries.[5] This article discusses the Report's recommendations with respect to the insurance industry. **Overview** The "Core Principles" which form the basis for the evaluation contained in the Report are found in Section 1 of the Executive Order:

1. to empower Americans to make independent financial decisions and informed choices in the marketplace, save for retirement, and build individual wealth;
2. to prevent taxpayer-funded bailouts;

3. to foster economic growth and vibrant financial markets through more rigorous regulatory impact analysis that addresses systemic risk and market failures, such as moral hazard and information asymmetry;
4. to enable American companies to be competitive with foreign firms in domestic and foreign markets;
5. to advance American interests in international financial regulatory negotiations and meetings;
6. to make regulation efficient, effective, and appropriately tailored; and
7. to restore public accountability within Federal financial regulatory agencies and rationalize the Federal financial regulatory framework.

Based upon Treasury's review of the regulatory framework, the Report identifies, in a high level summary fashion, the following "significant opportunities for reform," consistent with the Core Principles, that have particular applicability to the insurance industry:

1. ensuring appropriate evaluation of systemic risk and solvency;
2. promoting efficient regulation and rationalizing the regulatory framework to decrease regulatory burdens and maximize product and service offerings;
3. rationalizing U.S. engagement in international forums to promote the U.S. asset management and insurance industries, and encourage firm competitiveness; and
4. enhancing consumer access to a variety of relevant products and services.[6]

The Report generally affirms and attempts to build upon the state-based regulation of the insurance industry, seeks to promote a vibrant and financially healthy industry, and promote U.S. interests in the international insurance market and with non-U.S. insurance supervisors. **Recommendations with Respect to the Insurance Industry** Appendix B to the Report contains the Report's regulatory and legislative recommendations. It includes many recommendations with respect to the insurance industry, which are organized into the following subject areas: systemic risk (2 recommendations); preserving solvency – capital initiatives (2 recommendations); preserving solvency – liquidity initiatives (1 recommendation); role of state and federal regulation (5 recommendations); terrorism risk insurance program (3 recommendations); insurer data security (1 recommendation); insurer cyber threats (1 recommendation); product approval and speed to market (2 recommendations); producer licensing and appointments (2 recommendations); regulatory structures and issues of duplication, overlap, and fragmentation (2 recommendations); multilateral work on insurance (5 recommendations); advancing American competitiveness abroad (2 recommendations); insurer investment in infrastructure (1 recommendation); and retirement security (2 recommendations).[7] Some of the Report's specific insurance-related recommendations relate to the direct writing of insurance. Following are the recommendations which may be of the most relevance to, or have the most impact upon, the reinsurance sector:

1. systemic risk:

- move away from the entity-based system risk evaluations of insurance companies and towards an activities-based approach that would identify business activities that have higher systemic risk characteristics;
- support the International Association of Insurance Supervisors (“IAIS”) in its focus on an activities-based approach; and
- support the improvement of the IAIS's methodology for identifying global systemically important insurers.

2. preserving solvency – capital initiatives:

- Domestically - harmonize the group capital initiatives of the NAIC, the states, and the Federal Reserve to reduce duplicative regulatory burdens for insurers; and
- Internationally - recommend that the IAIS: (1) in developing its Insurance Capital Standard (“ICS”), “recognize the diverse approaches to solvency” by various regulators to ensure that the business model of U.S. insurance companies and the state-based insurance regulatory system of the U.S. are accommodated; and (2) postpone the next version of the ICS to allow further consultation with IAIS members and stakeholders on the development of an ICS that is implementable in all major insurance markets.

3. preserving solvency – liquidity initiatives:

- Domestically – encourage states, the NAIC, and the Federal Reserve to continue work on addressing potential liquidity risk in the insurance industry; and
- Internationally – the Federal Insurance Office (“FIO”) will advocate for the improvement of international liquidity management and planning standards.

4. role of state and federal regulation:

- Increase the transparency of the FIO’s activities and engage with state regulators more regularly and consistently;
- Coordinate data requests, data report format, and examinations between state regulators, the NAIC, and the Federal Reserve; and

- Clarify the Dodd-Frank business of insurance exception to ensure that the Consumer Financial Protection Bureau does not engage in the oversight of activities as to which state insurance departments are engaged.

5. terrorism risk insurance program:

- take steps to encourage private insurers to participate in the market for terrorism insurance; and
- simplify and reduce inconsistent data calls in this area.

6. insurer data security: recommend that states adopt the NAIC Insurance Data Security Model Law and, if uniform requirements are not adopted in five years, pass federal legislation setting forth data security and data security breach notification standards specific to insurers, with state insurance regulators to enforce such standards.
7. insurer cyber threats:

- encourage the sharing of information within the insurance industry regarding issues related to cybersecurity; and
- the FIO shall establish a working group to assess cybersecurity challenges for the insurance sector and issue cybersecurity recommendations to companies and state insurance regulators.

8. regulatory structures and issues of duplication, overlap, and fragmentation:

- federal agencies and entities shall establish formal mechanisms to promote coordination and communication with respect to insurance-related issues; and
- states should be consulted and afforded the opportunity to provide input when the business of insurance is implicated at the federal level, with the FIO leading the coordination with respect to such issues.

9. multilateral work on insurance:

- the work of the Financial Stability Board should be limited to global financial stability, with any insurance-related issues tailored to the insurance industry and utilizing the expertise of the IAIS when appropriate;
- the structure of the IAIS should reflect geographical balance in its representation and committee leadership;
- the decision-making of the IAIS should be more transparent, and should include better coordination with its stakeholders, including U.S. state insurance regulators;

- the FIO shall engage at the IAIS to: (1) advocate for the U.S. state-based insurance regulatory structure, the interests of U.S. companies and consumers, and the growth of the broader U.S. economy; (2) coordinate and present the U.S. position on issues of interest with a unified voice; and (3) promote greater transparency in international standard-setting forums; and

- U.S. representatives at the IAIS should advance positions that best represent the interests of the U.S. insurance sector, consumers, the state-based regulatory system, and the U.S. economy.

10. advancing American competitiveness abroad:

- engage in bilateral and multilateral discussions concerning the access to insurance markets, and encourage the IAIS to evaluate whether market access restrictions are consistent with the IAIS's core principles; and

- the FIO will coordinate the implementation of the Covered Agreement with state insurance regulators and pertinent federal stakeholders, and will explore whether to enter into similar agreements with other foreign jurisdictions, with a post-Brexit U.K. being mentioned in some discussions.

11. insurer investment in infrastructure: state insurance regulators and the NAIC should evaluate potential steps to encourage revising Risk-Based Capital charges to encourage high-quality infrastructure investments as opposed to general equity investments with more volatile returns.

While some of these recommendations can be accomplished through executive action or through executive agencies, many will require the cooperation of Congress, state regulators, or other bodies outside of the President's control, making it unclear how successful President Trump will be in implementing the recommendations of the Report. [1] The Report is available at https://www.treasury.gov/press-center/news/Pages/A-Financial-System-That-Creates-Economic-Opportunities---Asset-Management-and-Insurance.aspx. [2] Executive Order 13772: *Presidential Executive Order on Core Principles for Regulating the United States Financial System* (Feb. 3, 2017), available at https://www.whitehouse.gov/the-press-office/2017/02/03/presidential-executive-order-core-principles-regulating-united-states. [3] Report Section 2. [4] The Report describes the asset management industry as encompassing the management by professional asset managers of assets on behalf of investors, businesses, and other institutions using different types of funds and other investment structures. Report at 4-5. [5] The Report describes the insurance industry generally as including property, casualty, life, and health insurance, without mentioning reinsurance. Report at 5. [6] Report at 6. [7] Report at 158-63. This article was originally published in Harris Martin's publication *Reinsurance and Arbitration*, as well as the Carlton Fields' *Reinsurance Focus* blog.