



# The Dodd-Frank Wall Street Reform and Consumer Protection Act: Insurance Provisions

**Baird Webel**  
Specialist in Financial Economics

August 17, 2010

Congressional Research Service

7-5700

[www.crs.gov](http://www.crs.gov)

R41372

## Summary

In the aftermath of the recent financial crisis, broad financial regulatory reform legislation was advanced by the Obama Administration and by various Members of Congress. Ultimately Congress passed, and the President signed, the Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203).

The Dodd-Frank Act largely responded to the financial crisis that peaked in September 2008, but other efforts at revising the state-based system of insurance regulation also pre-date this crisis. Members of Congress previously introduced both broad legislation to federalize insurance regulation along the lines of the regulation of the banking sector, as well as more narrowly tailored bills addressing specific perceived flaws in the state-based system.

The financial crisis, particularly the role of insurance giant American International Group (AIG) and the smaller bond insurers, changed the tenor of the existing debate around insurance regulation, with increased emphasis on the systemic importance of some insurance companies. Although it could be argued that insurer involvement in the financial crisis suggested a need for full-scale federal regulation of insurance, the Dodd-Frank Act did not implement such a federal regulatory system for insurance.

Title V of the Dodd-Frank Act addressed specifically insurance, with a subtitle creating a Federal Insurance Office (similar to language originally contained in H.R. 2609) and a subtitle streamlining the existing state regulation of surplus lines and reinsurance (similar to language originally contained in H.R. 2572/S. 1363). The Federal Insurance Office is to monitor all aspects of the insurance industry and coordinate and develop policy relating to international agreements. It also has limited authority to preempt state laws and regulations when these conflict with international agreements. The act harmonizes, and in some cases reduces, regulation and taxation of surplus lines insurance by vesting the “home state” of the insured with the sole authority to regulate and collect the taxes on a surplus lines transaction. For reinsurance transactions, the act vests the home state of the insurer purchasing the reinsurance with the authority over the transaction while vesting the home state of the reinsurer with the sole authority to regulate the solvency of the reinsurer.

In addition to Title V’s specific insurance provisions, various other parts of the act may affect insurers and the insurance industry, including provisions addressing systemic risk, consumer protection, investor protection, and securities regulation.

This report explains how insurance markets were affected by the financial crisis and summarizes the provisions of the Dodd-Frank Act that pertain to insurance. It will not be updated.

## **Contents**

Insurance and the Financial Crisis .....	1
The Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203) .....	2
Federal Insurance Office .....	2
Consumer Financial Protection.....	3
Investor Protection and Securities Provisions .....	3
Systemic Risk Provisions .....	4
Surplus Lines and Reinsurance.....	5

## **Contacts**

Author Contact Information .....	5
----------------------------------	---

## Insurance and the Financial Crisis

Under the McCarran-Ferguson Act of 1945,<sup>1</sup> insurance regulation is generally left to the individual states. For several years prior to the recent financial crisis, some Members of Congress had introduced legislation to federalize insurance regulation along the lines of the regulation of the banking sector, although none of this legislation reached the committee markup stage.<sup>2</sup> Various other pieces of legislation have also been introduced to reform insurance regulation in more narrow ways.<sup>3</sup> The debate around federal involvement in insurance regulation had traditionally focused on the negative and positive aspects of the state-centered approach compared to increased federal government involvement.

The recent financial crisis, particularly the involvement of insurance giant American International Group (AIG) and the smaller bond insurers, changed the tenor of the debate around insurance regulation. The crisis grew largely from sectors of the financial industry that had previously been perceived as presenting little systemic risk. Many see the crisis as resulting from failures or gaps in the financial regulatory structure, particularly a lack of oversight for the system as a whole and a lack of coordinated oversight for the largest actors in the system.<sup>4</sup> This increased urgency in calls for overall regulatory changes, such as the implementation of increased systemic risk regulation and federal oversight of insurance, particularly of larger insurance firms. Generally good performance of insurers through the crisis, however, has also provided additional arguments for those seeking to retain the state-based insurance system.

Although insurers in general appear to have weathered the financial crisis reasonably well, the insurance industry saw two significant failures, one general and one specific. The first failure involved financial guarantee or “monoline” bond insurers. Before the crisis, there were only about a dozen bond insurers in total, with four large insurers<sup>5</sup> dominating the business. This type of insurance originated in the 1970s to cover municipal bonds, but the insurers expanded their businesses since the 1990s to include significant amounts of mortgage-backed securities. In late 2007 and early 2008, strains appeared due to exposure to mortgage-backed securities. Ultimately some smaller bond insurers failed and the larger insurers saw their previously triple-A credit ratings downgraded significantly. These downgrades rippled throughout the municipal bond markets, causing unexpected difficulties for both individual investors and municipalities who might have thought they were relatively insulated from problems stemming from rising mortgage defaults.

The second failure in the insurance industry was that of a specific company, AIG.<sup>6</sup> AIG had been a global giant of the industry, but it essentially failed in mid-September 2008. To avoid bankruptcy in September and October 2008, AIG was forced to seek more than \$100 billion in

---

<sup>1</sup> 15 U.S.C. Sec. 1011 *et seq.*

<sup>2</sup> See CRS Report RL34286, *Insurance Regulation: Federal Charter Legislation*, by Baird Webel.

<sup>3</sup> See CRS Report R40771, *Insurance Regulation: Issues, Background, and Legislation in the 111<sup>th</sup> Congress*, by Baird Webel.

<sup>4</sup> See, for example, the remarks by SEC Chairman Mary L. Schapiro from the University of Rochester’s Presidential Symposium on the Future of Financial Regulation, available at <http://www.sec.gov/news/speech/2009/spch101009mls.htm>.

<sup>5</sup> Ambac, FGIC, FSA, and MBIA.

<sup>6</sup> See CRS Report R40438, *Ongoing Government Assistance for American International Group (AIG)*, by Baird Webel.

assistance from, and give 79.9% of the equity in the company to, the Federal Reserve. Multiple restructurings of the assistance have followed, including up to \$69.8 billion through the U.S. Treasury's Troubled Asset Relief Program (TARP). AIG is currently in the process of selling off parts of its business to pay back assistance that it has received from the government; how much value will be left in the 79.9% government stake in the company at the end of the process remains an open question.

The near collapse of the bond insurers and AIG could be construed as regulatory failures. One of the responsibilities of an insurance regulator is to ensure that insurers remain solvent and are able to pay future claims. Because the states are the primary insurance regulators, some may go further and argue that these cases specifically demonstrate the need for increased federal involvement in insurance. The case of AIG, however, is complicated. AIG was primarily made up of state-chartered insurance subsidiaries, but the state insurance regulators did not oversee the entire company. At the holding company level, AIG was a federally regulated thrift holding company and thus overseen by the Office of Thrift Supervision (OTS). The immediate losses that caused AIG's failure came from both derivatives operations overseen by OTS and from securities lending operations that originated with securities from state-chartered insurance companies. OTS claimed that it had sufficient regulatory authority and competence to oversee a complicated holding company such as AIG. Others, particularly the Federal Reserve, disputed this claim and argued that a single body is needed to oversee systemic risk and large financial holding companies.

## **The Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203)**

The Dodd-Frank Act was passed in the House on June 30, 2010, by vote of 237-192, and in the Senate, on July 15, 2010, by a vote of 60-39. President Obama signed the legislation, now P.L. 111-203, on July 21, 2010.

### **Federal Insurance Office**

Title V, Subtitle A of the Dodd-Frank Act creates a Federal Insurance Office (FIO) inside of the Department of the Treasury. A similar office was previously proposed in a 2008 Treasury "Blueprint for a Modernized Financial Regulatory Structure,"<sup>7</sup> in H.R. 5840 in the 110<sup>th</sup> Congress, and in H.R. 2609 in the 111<sup>th</sup> Congress.

FIO is to monitor all aspects of the insurance industry and coordinate and develop policy relating to international agreements. It has the authority to preempt state laws and regulations when these conflict with international agreements. This preemption authority is somewhat limited. It can only apply when the state measure (1) results in less favorable treatment of a non-U.S. insurer compared with a U.S. insurer, and (2) is inconsistent with a written international agreement regarding prudential measures. Such an agreement must achieve a level of consumer protection

---

<sup>7</sup> See U.S. Treasury, "Treasury Releases Blueprint for Stronger Regulatory Structure," press release, March 31, 2008, <http://www.ustreas.gov/press/releases/hp896.htm>.

that is “substantially equivalent”<sup>8</sup> to the level afforded under state law. FIO preemption authority does not extend to state measures governing rates, premiums, underwriting, or sales practices, nor does it apply to state coverage requirements or state antitrust laws. FIO preemption decisions are also subject to *de novo* judicial review under the Administrative Procedures Act.<sup>9</sup> The monitoring function of FIO includes information gathering from both public and private sources. This is backed by subpoena power if the director issues a written finding that the information being sought is necessary and that the office has coordinated with other state or federal regulators that may have the information.

## **Consumer Financial Protection<sup>10</sup>**

Title X of the Dodd-Frank Act creates a Bureau of Consumer Financial Protection within the Federal Reserve. This bureau enjoys significant budgetary independence, and the director is to be appointed by the President and confirmed by the Senate. Consumer protection issues relating to the business of insurance, however, do not fall under the oversight of the bureau, but would remain within the purview of the states. Consumer protection issues that relate to insurance products that are also considered securities continue to be addressed by the Securities and Exchange Commission (SEC).

## **Investor Protection and Securities Provisions<sup>11</sup>**

Although insurance products are generally under state regulation, there are some products, particularly variable annuities, that are considered securities products under federal law and jointly overseen by the SEC. In 2008, the SEC adopted new rules, generally known as “Rule 151A,” that would have expanded SEC oversight to include some fixed indexed annuities that previously had solely been overseen by the states as insurance products. This rule provoked controversy, with Representative Gregory Meeks and Senator Benjamin Nelson introducing the Fixed Indexed Annuities and Insurance Products Classification Act of 2009 (H.R. 2733/S. 1389) to overturn Rule 151A. H.R. 4173 included no provisions addressing Rule 151A as it moved through consideration in the House, and neither did S. 3217 in the Senate. Senator Tom Harkin proposed S.Amdt. 3920, which would have added the text of H.R. 2733/S. 1389 to S. 3217; but the amendment was not considered on the floor of the Senate.

The conference committee agreed to an amendment by Senator Harkin, contained in Section 989J of the act, that did not insert the previous language specifically nullifying Rule 151A, but is broadly aimed at returning indexed annuities solely to state oversight. The exemption from SEC oversight in Section 989J depends in part on either the states or the companies meeting certain consumer protection standards. Depending on future regulatory action by the SEC, this exemption language may require court action before the full impact of Section 989J is known.

---

<sup>8</sup> 31 U.S.C. §313(r)(2) as added by P.L. 111-203 §502; the law renumbers the current 31 U.S.C. sec. 313 as 31 U.S.C. Sec. 312.

<sup>9</sup> 5 U.S.C. §551 *et seq.*

<sup>10</sup> See CRS Report R41338, *The Dodd-Frank Wall Street Reform and Consumer Protection Act: Title X, The Consumer Financial Protection Bureau*, by David H. Carpenter.

<sup>11</sup> See CRS Report RS22974, *Annuities and the Securities and Exchange Commission Rule 151A*, by Baird Webel.

In addition to the language on annuities, Section 913 of the act may affect some insurance producers who also sell security products. This section authorizes the SEC to establish a fiduciary duty for broker-dealers who give personalized investment advice. SEC-registered investment advisers are already subject to a fiduciary duty, which requires them to act in their customers' best interests. Broker-dealer recommendations, on the other hand, must be suitable for customers; the act directs the SEC to harmonize the standards applicable to broker-dealers and investment advisers. This provision is of interest to the insurance industry because agents who sell securities products, such as mutual funds or variable annuities, have been required to register as broker-dealers, but not generally as investment advisers. If the SEC issues rules creating a fiduciary duty, such agents will have to meet the best-interests standard that applies to advisers.

## **Systemic Risk Provisions<sup>12</sup>**

The Dodd-Frank Act provides for systemic risk provisions that affect the insurance industry primarily through oversight of firms deemed systemically significant and through specific financial resolution authority. Financial companies, including insurers, judged to be systemically significant by the Financial Stability Oversight Council are to be subject to Federal Reserve oversight and higher prudential standards. The council includes a presidential appointee who is to be familiar with insurance issues, a state insurance commissioner, and the director of the Federal Insurance Office with the latter two being non-voting members.

Section 619 of the Dodd-Frank Act includes restrictions on proprietary trading by banking entities, a provision commonly known as the "Volcker Rule." Insurers that have banking subsidiaries or who are under a holding company structure with other banking subsidiaries would be subject to these restrictions, potentially affecting the investment strategies of these insurers. The language, however, includes an exemption for trading done "by a regulated insurance company directly engaged in the business of insurance for the general account of the company by any affiliate of such regulated insurance company, provided that such activities by any affiliate are solely for the general account of the regulated insurance company."<sup>13</sup> The transactions must also comply with applicable law, regulation, or guidance; and there must be no determination by the regulators that a relevant law, regulation, or guidance is insufficient to protect the safety and soundness of the banking entity or the financial stability of the United States.<sup>14</sup>

A financial company could be subject to the act's special resolution regime based on a finding that its failure would cause systemic risk. Any insurance subsidiaries of such a financial company, however, would not be subject to this regime. Instead, the resolution of insurance companies would continue to be conducted in accordance with the applicable state insurance resolution system. With regard to funding for the resolution of systemically significant financial firms, there is no pre-funded resolution mechanism under the act. Instead, the Federal Deposit Insurance Corporation (FDIC) is to impose assessments on financial companies with more than \$50 billion in assets, as well as other financial firms that are overseen by the Federal Reserve, to fund the resolution of a systemically significant firm in the event the assets of the failed firm are insufficient to do so. The FDIC is to impose such assessments on a risk-adjusted basis. When

---

<sup>12</sup> See CRS Report R40877, *Financial Regulatory Reform: Systemic Risk and the Federal Reserve*, by Marc Labonte.

<sup>13</sup> P.L. 111-203 §619(d)(1)(F).

<sup>14</sup> This description is from CRS Report R41298, *The "Volcker Rule": Proposals to Limit "Speculative" Proprietary Trading by Banks*, by David H. Carpenter and M. Maureen Murphy; please see this report for additional information on the proposal.



imposing such assessments on an insurance company, the FDIC is to take into account the insurers' contributions to the state insurance resolution regimes.

## **Surplus Lines and Reinsurance<sup>15</sup>**

Title V, Subtitle B of the Dodd-Frank Act is entitled the Nonadmitted and Reinsurance Reform Act of 2010 and includes essentially the same language as H.R. 2571/S. 1361. Similarly titled bills were introduced in the 109<sup>th</sup> and 110<sup>th</sup> Congresses and passed the House, but were not considered by the Senate.

This language addresses a relatively narrow set of insurance regulatory issues pre-dating the financial crisis. In the area of nonadmitted (or “surplus lines”) insurance, the act harmonizes, and in some cases reduces, regulation and taxation of this insurance by vesting the “home state” of the insured with the sole authority to regulate and collect the taxes on a surplus lines transaction. Those taxes that would be collected may be distributed according to a future interstate compact, but absent such a compact their distribution would be within the authority of the home state. It also preempts any state laws on surplus lines eligibility that conflict with the National Association of Insurance Commissioners (NAIC) model law and implements “streamlined” federal standards allowing a commercial purchaser to access surplus lines insurance. For reinsurance transactions, it vests the home state of the insurer purchasing the reinsurance with the authority over the transaction while vesting the home state of the reinsurer with the sole authority to regulate the solvency of the reinsurer.

## **Author Contact Information**

Baird Webel  
Specialist in Financial Economics  
bwebel@crs.loc.gov, 7-0652

---

<sup>15</sup> See CRS Report RS22506, *Surplus Lines Insurance: Background and Current Legislation*, by Baird Webel.