The In-House Lawyer: Comparative Guides

United States: Insurance & Reinsurance

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This country-specific Q&A gives a pragmatic overview of the law and practice of insurance & reinsurance law in the United States.

It addresses topics such as **contract regulation, licensing, penalties, policyholder protection, alternative dispute resolution** as well as personal insight and opinion as to the future of the insurance market over the next five years.

This Q&A is part of the global guide to Insurance & Reinsurance. For a full list of jurisdictional Insurance & Reinsurance Q&As visit http://www.inhouselawyer.co.uk/index.php/practice-areas/insurance-reinsurance

1. How is the writing of insurance contracts regulated in the jurisdiction?

The insurance business in the United States is regulated primarily by each of the 50 states, the District of Columbia and Puerto Rico. There are federal laws that apply to insurance and annuities that are part of federally covered retirement plans, and the federal securities laws (in addition to state insurance laws) regulate variable insurance and annuity products. Virtually all other aspects of insurance – including formation and licensing, solvency requirements, approving the contents of insurance contracts, setting or approving insurance rates and responding to consumer complaints – are regulated by the individual states. The state-based system of insurance regulation has been in place in the U.S. since the 1800s and was strengthened in 1945 with the enactment of the McCarran-Ferguson Act, which expressly provides that the business of insurance is to be regulated by the states and exempts the business of insurance from many federal laws (subject to exceptions).

The chief insurance regulator in each state, called a commissioner, director or superintendent, leads the state agency responsible for insurance regulation, which is often called an insurance department. Most commissioners are appointed by the governor of the state, but many are elected.

U.S. insurers are primarily regulated by the insurance department in their state of domicile. However, insurers must also be licensed in all states where they sell their products and are also subject to some laws and regulations in those states as well. State laws govern the permissible kinds of insurance contracts that may be offered in the state, the contents of policy forms and, for certain insurance contracts, the rates that may be charged. State insurance laws also regulate insurer solvency and reserving requirements, financial reporting and corporate governance, insurer sales practices, liquidation and rehabilitation of insolvent or impaired insurers, and licensing and educational requirements for agents, brokers and others who interact with insurers and consumers.

State insurance commissioners regularly meet through the National Association of Insurance Commissioners (NAIC) to develop model laws and regulations. The NAIC is not a regulator and the models it develops are not binding unless enacted or adopted by a state. The NAIC produces publications that contain standards

(e.g., statutory accounting principles) that are incorporated by reference in state laws or regulations.

The regulation of insurance by the states is primarily focused on the legal entity (the insurer) that is incorporated and/or licensed in such state rather than the group or holding company system as a whole. Although certain state insurance laws authorize the insurance regulator to seek information from, and approve transactions with, non-insurer affiliates, they generally do not provide insurance regulators with the same broad oversight powers with respect to non-insurer members of an insurance group.

2. Are types of insurers regulated differently (i.e. life companies, reinsurers)?

Different kinds of insurers may be subject to different rules with respect to certain aspects of their business. For example, most state insurance laws differentiate between the reserving and financial requirements applicable to life, property/casualty and health insurers. Additionally, some states have separate rules for the payment of dividends and permissible investments by life and non-life insurers. Although the regulation of rates and forms varies among the states, life insurance rates are generally not regulated while rates for non-life personal lines insurance, such as health or automobile insurance, are more likely to be regulated by the insurance department. Life insurance policy forms generally must be approved before being sold, while some commercial property/casualty forms may be used without regulatory review. Certain specialty insurers, such as financial guaranty or title insurers, may be subject to additional and/or different insurance rules.

Reinsurers are subject to a number of the rules that apply to direct insurers, including licensure. However, some states have adopted rules allowing reinsurers that are “certified” or “accredited” – rather than licensed – to operate in such states. In addition, insurers may reinsure business to reinsurers that are not licensed, certified or accredited in their state of domicile if appropriate security is provided. The status of a reinsurer is an important factor in determining how much reinsurance credit a ceding insurer may claim without requiring the reinsurer to secure its obligations.

3. Are insurance brokers and other types of market intermediary subject to regulation?

All states require agents, brokers and other market intermediaries to be licensed in order to sell, solicit or negotiate insurance and prohibit anyone without a license from performing these activities. An insurance license is generally required for a person to receive commissions or other compensation for the sale of insurance, which may not be shared with unlicensed persons.

State insurance laws refer to licensed persons as agent, broker, producer or combinations of the foregoing. A common difference between agents and brokers is that agents work on behalf of the insurer while brokers represent the insured. Generally, an agent, but not a broker, has to be appointed by an insurer and such appointment has to be filed with the state insurance department.

States generally grant agent or broker licenses to individuals and corporate entities, but an entity license usually requires an individual associated with the entity to be licensed in an individual capacity. Licensing laws may contain narrow exceptions (for example, employees of licensed insurers), but generally anyone who interacts with an insurance consumer or potential insurance consumer has to pass a licensing examination to receive a license from each state in which such person acts as an agent or broker.

States may have separate licensing requirements for life, health and property/casualty agents and brokers and some licensing laws distinguish between personal lines and commercial lines licenses. States may also require license applicants to satisfy pre licensing educational requirements before being eligible to take a licensing examination and many have continuing professional education requirements.

The licensing process requires an applicant to disclose general background information, including detailed

information about character, experience and financial responsibility. A criminal background check is often conducted by the state insurance department.

State insurance commissioners regulate insurance market intermediaries through monetary penalties and the ability to suspend or revoke a license. Permissible grounds for such actions are generally set forth in state insurance laws and include violations of any insurance law or order, criminal convictions, being subject to enforcement by another state, engaging in fraudulent or dishonest business practices, or demonstrating incompetence. In most cases, the licensee has a right to a hearing regarding the administrative action before it is taken.

Other insurance market participants, such as reinsurance intermediaries, insurance consultants, adjusters and/or third party administrators are usually subject to state insurance regulation, including licensing requirements in each state where the relevant insurance activities take place.

4. Is authorisation or a licence required and if so, how long does it take on average to obtain such permission?

The time to obtain an insurance agent or broker license depends on several factors. First, the applicant must satisfy any applicable pre-licensing educational requirements (or rely on an exemption) and then pass a licensing examination. Then an applicant would need to submit a licensing application to the "home state," the state in which the applicant resides or conducts an insurance business. Many states now allow licensing applications to be submitted electronically, thereby reducing processing time. After the person's home state issues a license, the person may apply for a non-resident license in every other state in which such person intends to conduct an agency or brokerage business. Most states have adopted licensing reciprocity rules, allowing a person licensed in his or her home state to become licensed in another state with substantially similar licensing requirements without taking another examination or satisfying educational requirement anew. Reciprocity rules apply only with respect to the lines of authority for which such person is licensed in the home state. Thus, a person with a life agent license in the person's home state can only obtain a life agent (or equivalent) license in other states.

5. Are there restrictions over who owns or controls insurers (including restrictions on foreign ownership)?

State insurance laws regulate who may own or control an insurance company by imposing pre-approval requirements for the formation and incorporation of new insurers and for any change of control of existing insurers.

Insurance companies may be formed under a state's insurance laws, corporation laws or both. Insurance laws generally require that the proposed officers and directors of a newly formed insurer and the individuals who directly or indirectly would control the newly formed insurer disclose their background information, including professional and financial history and administrative proceedings or criminal enforcement actions relating to their trustworthiness and character. The information is used by state insurance departments to conduct criminal and financial background investigations, and some states also require that proposed officers and directors submit fingerprints as part of the investigation.

More than half of the states restrict or prohibit the licensing of insurers that are owned or controlled by government entities. Such restrictions most often impact acquisitions of U.S. insurers by non-U.S. persons. In recent years, however, many of these laws have been relaxed so that they prohibit acquirers only if they are both government-owned and benefit from a government subsidy.

Many of the same requirements and restrictions that apply to the regulatory review of proposed officers,

directors and the individuals who directly or indirectly would control the newly formed insurance company also apply when there is a change of control of an insurer. Ultimate controlling persons are also required to provide audited financial statements as part of their application and to disclose their plans for the target insurer. A change of control of an insurer is subject to prior approval by the insurance commissioner of the state in which the insurer is domiciled, whether an acquisition of control is effected through a tender offer, open market purchases or in any other manner, and irrespective of whether control will be direct or indirect (i.e., whether the acquisition is of an insurer or an entity that itself controls an insurer). Acquiring an insurance holding company system that includes multiple insurers domiciled in different states would require the prior approval of the insurance commissioner of each state in which each insurer within the system is domiciled.

6. Is it possible to insure risks without a licence or authorisation? (i.e. on a non-admitted basis)?

States generally allow insurers that are not licensed in the state to insure risks on an "excess" or "surplus" lines basis. Excess line insurers are generally authorized to insure large, commercial risks and/or specialty risks for which coverage in the admitted market is unavailable (e.g., terrorism insurance, liability insurance for large infrastructure projects). States restrict the kinds of insurance that may be written on a non-admitted basis. Personal lines insurance, including life, annuities, private passenger automobile and residential homeowner insurance, is usually excluded from permissible surplus lines coverage. State insurance laws generally require that excess and surplus insurers conduct business in a state only through a licensed broker or other licensed person.

7. What penalty is available for those who operate without appropriate permission?

A person or entity without an insurance license that conducts insurance activities that require a license is usually subject to monetary penalties imposed by the state insurance commissioner. State laws may empower the commissioner to enforce monetary penalties by resorting to the courts of the state or directly by the state insurance agency. The insurance laws of some states provide that certain insurance violations constitute criminal violations.

8. How rigorous is the supervisory and enforcement environment?

States' regulatory approaches to insurance supervision and enforcement differ depending on various factors, including the nature and magnitude of a violation, the extent of any harm to policyholders (or specific classes of policyholders, such as senior citizens), the political environment (both local and national) and the limits imposed on administrative action by the relevant state laws.

Despite variations in supervision and enforcement, states have been regulating the business of insurance for over a century and are accustomed to enforcing fundamental insurance safeguards and requirements consistently, especially those that relate to solvency, sales practices, rebating and consumer protection.

9. How is the solvency of insurers (and reinsurers where relevant) supervised?

State insurance laws require that all domestic insurers undergo a financial solvency examination by the insurance department generally every three to five years, but as often as the regulator deems prudent. Furthermore, insurers are required to file quarterly and annual financial statements with their domestic state insurance regulators; annual statements must be certified by an independent public accountant. The financial statements are available through the NAIC to any other state regulator. Insurers are also subject to and annually must report their risk-based capital.

Risk-based capital measures an insurer's capital requirements based on the kinds and amounts of risk included in an insurer's assets and liabilities. Insurers with higher amounts of risk are required to hold higher amounts of capital. Risk-based capital calculations provide a tool to monitor financial solvency and set thresholds for regulatory actions ranging from requiring remediation plans to placing the insurer in delinquency proceedings.

In addition, insurance regulators regularly review transactions subject to pre-approval for their potential impact on solvency, including affiliate agreements, certain investments, purchases or sales, and extraordinary dividends. Some states authorize the insurance commissioner to demand any information from the insurer or any member of its holding company system that may affect the insurer's solvency and to order the insurer to raise capital. An insurer's failure to remedy a capital impairment may result in an order to cease writing new insurance contracts until the impairment has been fixed.

10. What are the minimum capital requirements?

All state insurance laws set forth minimum capital and surplus requirements in order obtain a license to write insurance. The minimum requirements differ among the states and vary according to the kind of insurance that will be offered and the number of lines of business that are included in the license. The minimum capital levels were set, in many cases, years or decades ago and are relatively low by today's standards.

Thus, in practice, state insurance regulators often require far higher levels of capital as a condition of licensure or a change of control. The regulator's determination of the required capital level is based largely on the kind of insurance business at issue and the insurer's business plan and financial projections.

As noted above, risk-based capital requirements play a significant role in measuring capital requirements for insurers based on the amount and risk in an insurer's assets and liabilities.

11. Is there a policyholder protection scheme?

Policyholder protection schemes in the U.S. – state guaranty funds or security funds – are established and regulated by each of the states. States may have a separate guaranty fund for different kinds of insurance (life, health, property), as well as security funds for specialized insurance, such as title insurance. All states have a life insurance guaranty fund, which includes coverage for annuity contracts.

A state guaranty fund provides coverage for the payment of an insolvent insurer's policyholder obligations and is usually established and operated by a nonprofit association, as set forth in the state's insurance law. The members of the "guaranty association" are insurance companies doing business in the state and membership in the guaranty association is a condition of licensure. The member insurance companies appoint a board of directors to operate and manage the guaranty association, which is generally under the authority of the state insurance regulator. In some cases, the state insurance commissioner or another state official may be an ex officio member of the board.

The guaranty association establishes a guaranty fund through assessments on the member insurance companies, the amount of which is usually based on the premiums written in that state by the insurer. The amount of coverage provided to policyholders by state guaranty funds varies among the states and depends on the kind of insurance covered by the fund.

12. How are groups supervised, if at all?

Increasingly, states have been considering adding authority to their insurance laws allowing the commissioner greater oversight of non-insurance members of an insurance group (or holding company system). Thus far, such efforts have generally been limited to participating in supervisory colleges and obtaining information

from non-insurance group members that may affect the insurer or the enterprise risk of the group.

13. Do senior managers have to meet fit and proper requirements and/or be approved?

As noted above, in connection with the formation of a new insurer or a change of control, proposed officers and directors must be approved by the insurer's domestic state regulator after successfully passing financial, professional and criminal background investigations.

14. How are sales of insurance supervised or controlled?

The sale of insurance is supervised through the licensing of agents, brokers and others who sell insurance. In addition, most states have developed rules and regulations regarding sales practices and marketing. State laws prohibit fraudulent or misleading sales practices and deceptive or confusing advertising materials. Many states require insurance companies to maintain copies of advertising and sales materials for examination by insurance regulators.

State insurance laws also prohibit insurers and agents/brokers from unfairly discriminating in the underwriting or sale of insurance based on factors such as race, ethnicity, religion, prior travel, credit history or residence.

State insurance regulators periodically perform market conduct examinations of insurers to review their compliance with consumer protection laws, rate and form filing requirements and sales practices regulations.

15. Are consumer policies subject to restrictions? If so, briefly describe the range of protections offered to consumer policyholders.

The insurance laws of many states provide special protections for consumer insurance policies (also called "personal lines" insurance). These include "free look" periods that allow consumers to return a policy for a full refund within a short period of time (typically five to thirty days) after purchasing it. Additionally, insurance laws sometimes mandate certain minimum benefits and coverage levels and limit an insurer's right to cancel or non-renew a policy.

16. Are the courts adept at handling complex commercial claims?

Most insurance coverage disputes are handled by state courts, although federal courts handle a significant amount of insurance disputes, often involving foreign insurers or parties from different states. The U.S. federal courts are generally considered adept at handling complex commercial claims. The level of business sophistication of the state courts varies, but some states have established commercially-focused courts within their court system to handle complex commercial claims.

17. Is alternative dispute resolution well established in the jurisdiction?

Arbitration, mediation and other forms of alternative dispute resolution are generally well established across the states.

18. What are the primary challenges to new market entrants?

Primary challenges to new insurers entering the market include increased capital requirements for certain lines of business (e.g., variable annuities with guarantees) as well as potentially high regulatory compliance costs.

19. **To what extent is the market being challenged by digital innovation?**

The insurance market in the U.S. is beginning to reflect the impact of increased digital innovation. The growth of new technologies that harness digitalization and provide greater efficiency within the current insurance industry model follows an industry shift toward a consumer-driven approach, which fosters greater product personalization, and empowers industry participants to offer new products and deliver current products more efficiently. State insurance regulators will need to consider whether existing insurance laws are sufficient to address new regulatory issues that may arise from the increased use of technology or whether new or different rules should apply.

20. **Over the next five years what type of business do you see taking a market lead?**

The next five years are likely to be a period of significant change. Potential regulatory reform, increased infrastructure spending, tax reform and changes to trade policy are all likely to affect the U.S. economy in general. Technological changes, both in the way insurance products are underwritten, sold and administered and more generally in the way individuals live their lives (e.g., the advent of autonomous cars) are also likely to unfold in the next 5 years. Insurers that are nimble and able to adapt and respond to these changes are likely to take market leading positions.