SUPERVISORY COLLEGES: IMPROVING INTERNATIONAL SUPERVISORY COORDINATION

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This article looks at the insurance industry in the context of its role as a key player in the international financial system. Specifically, how insurers and regulators alike are working towards a higher level of cooperation and coordination, both within their own jurisdictions and beyond, to assure that events such as the 2008 Financial Crisis are never repeated. The article focuses on the rise of supervisory colleges and explains the need for states to meaningfully participate in these international forums which have the potential to identify and eliminate systemic risk. The benefits as well as the obstacles presented by such a grand scheme of international supervision are laid out in detail by the author, who closes by making the case for supervisory colleges as a "step in the right direction for international regulatory success."

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The 2008 Financial Crisis was a devastating wake up to how institutions, both domestically and internationally, are systemically connected in ways regulators did not know existed. To prevent a future breakdown, the United States is working towards identifying risks that are inherent in those connections, and mitigating potential harm to the financial system before it occurs. Inextricably tied into this equation are insurance companies.

In the realm of insurance regulation, there are two trends working towards the same goal of international coordination and cooperation to create a more globally sustainable system of supervision. First, there are the efforts of the National Association of Insurance Commissioners ("NAIC"), representing state regulated insurance. The NAIC has created task groups to address flaws in the United States insurance regulatory scheme to better identify weaknesses before they escalate into systemic risks. Second, there is the creation of the Federal Insurance Office ("FIO"), representing the federal government's movement into the realm of state dominated insurance. The FIO has been charged with monitoring all aspects of the insurance industry to identify gaps in the regulatory regime that could lead to a systemic financial crisis. In theory, it appears that the state and federal efforts are near mirror images of each other, but in

practice, the states still hold the power. In order to keep control of that power, states and the NAIC are overhauling certain parts of the current insurance regulatory scheme to ensure that the FIO has no other reason but to remain an ally.

In particular, the NAIC is encouraging state insurance commissioners to participate in international forums where supervisors from across the world come together for the regulation, evaluation, and investigation of those insurance companies under their jurisdiction that are part of groups with cross-border operations. These forums are called supervisory colleges. This paper posits that supervisory colleges are a way to enhance state based insurance regulation in an increasingly international environment, but there are several obstacles that must first be addressed, and several concerns that may never go away.

The discussion will read as follows: Part I will introduce the relevant NAIC initiatives for improved supervision; Part II will discuss the controversial new revisions to the Insurance Holding Company System Model Act that exponentially expand a state commissioner's access to information; Part III provides an overview and introduction to supervisory colleges; Part IV discusses confidentiality amongst participating regulators in a supervisory college; Part V briefly discusses the potential implications of the FIO's covered agreements and preemption powers; Part VI looks at Connecticut as a case study for recent developments in state involvement with supervisory colleges and international members; Part VII explains how the NAIC has facilitated state and foreign participation in supervisory colleges, as well as other efforts they have made in conjunction with the International Association of Insurance Supervisors; Part VIII addresses several obstacles and concerns presented by supervisory colleges; Part IX thoroughly discusses whether the authority for state insurance commissioners to participate in supervisory colleges, as well as the commissioner's expansion of powers, are within the McCarran-Ferguson Act's definition of the 'business of insurance'; and Part X concludes by recommending that the efforts taken thus far for state participation in supervisory colleges be continued in the future.

I. SOLVENCY MODERNIZATION INITIATIVE: THE INCEPTION OF SUPERVISORY COLLEGES TO IMPROVE GROUP SOLVENCY ISSUES.

The Solvency Modernization Initiative ("SMI") is a critical self-examination of the U.S. insurance solvency system by state insurance

regulators that began in June of 2008.[1] Through SMI the National Association of Insurance Commissioners ("NAIC") is working to identify potential weaknesses in the current regulatory scheme exposed by the 2008 financial crisis. The NAIC outlined its objectives for SMI in the "Work Plan," ranking US solvency framework (the "Framework"), group solvency issues, capital requirements, international accounting and regulatory standards, reinsurance, and corporate governance the top issues in need of attention.[2] Of particular relevance for this examination is the Group Solvency Issues Working Group (the "GSI Working Group") and its Draft Memorandum on Groupwide Supervision (the "Draft Memorandum"), and the recently adopted amendments (the "Amendments") to the NAIC's Insurance Holding Company System Model Regulatory Act and Regulation (the "IHCA").[3]

Insurers and their holding companies are no longer limited to their domiciliary states as separate legal entities; rather, they are more akin to financial enterprises with their operations extending across borders into multiple jurisdictions. In addition to the issues presented by cross-border operations, insurance companies are also subjected to cross-sector risks as part of a larger holding company. The GSI Working Group addresses how these issues impact U.S. insurers, and how state insurance commissioners and regulators can best mitigate the attendant risks. The Draft Memorandum notes that the U.S. insurance regulatory system has long operated with a "solo entity" approach to regulation, where focus channels on the insurer, whereas other jurisdictions have a more consolidated

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[1] *Insurance Oversight: Policy Implications for U.S. Consumers, Businesses and Jobs*: *Testimony Before the Subcomm. On Ins., Hous., and Cmty. Opportunity of the H. Comm. On Fin. Serv.*, 112th Cong. 10 (July 28, 2011) (statement of Susan E. Voss, President, Nat'l Ass'n Ins. Comm'rs) [hereinafter Statement of Susan E. Voss].

[2] Leah Campbell & Tonisha Calbert, *Overview of the NAIC's Solvency Modernization Initiative*, 18 METRO. CORP. COUNS. 20 (June 2010).

[3] The SMI Task force of the NAIC charged the GSI Working Group with "studying the current state of play of US group supervision recommending needed enhancements to the oversight of U.S. based insurers operating within corporate groups." *See* Memorandum from The Group Solvency Issues (EX) Working Group to Director Christina Urias, Chair of the Solvency Modernization Initiatives (EX) Task Force 1 (Feb. 26, 2010) (regarding: "Report to Solvency Modernization Initiative (EX) Task Force on Suggested "Windows and Walls" Approach for Regulation of United States Based Insurers Operating within Corporate Groups) [hereinafter Draft Memorandum].

approach to regulation, with focus on the entire holding company system.[4] The GSI Working Group's examination adopts an approach more analogous to the latter, investigating how the enterprise group's risks as a whole could potentially affect the insurance companies that operate under the group's direction.

To enhance group supervision, the Draft Memorandum suggests using a "windows and walls" approach to "provid[e] a window into group operations, while building upon, rather than rejecting, the existing walls which provide solvency protection to U.S. insurers."[5] In general, windows are regulatory enhancements that will strengthen review and access to group affiliate information, increase cooperation between regulatory jurisdictions, expand group financial assessment, and improve standards across regulatory jurisdictions.[6] Participation in supervisory colleges for internationally active groups fall under these 'windows."[7] More specifically, a selection of regulatory "windows" suggested by the Draft Memorandum includes: state coordination on a national basis for sharing confidential information with international regulators, a "proactive confidential communication" approach in crisis situations between state regulators and international supervisors,[8] access to meaningful information about unregulated entities, which include non-operating holding companies,[9] and a "panoramic" view of group capital.[10] Former NAIC

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[4] *See* Draft Memorandum, *supra* note 3, at 1. The Draft Memorandum goes on to explain that in some cases, the U.S. regulatory scheme could perhaps more accurately be described as "solo plus." *Id.* For instance, the U.S. supervisory regime employs a "lead" state concept for when two or more insurers that operate within a single group are domiciled in two separate states. *Id.*

[5] *See* Draft Memorandum, *supra* note 3, at 2. The goal of the "windows and walls" approach is to "provide much needed breadth and scope enhancements to solvency regulation while retaining the highest level of policyholder protection that exists currently." *Id.*

[6] *See Solvency Modernization in the Spotlight*, NAIC UPDATE 3, Deloitte LLP, (Spring 2010); *See also* Draft Memorandum, *supra* note 3, at 2-3.

[7] *See* Draft Memorandum, *supra* note 3, at 2. The GSI Working Group believes supervisory colleges to be, "the best optics . . . to be used to navigate through any potential financial crisis." *Id.*

[8] The Draft Memorandum suggests an enhanced "Master MoU" as the mechanism to use when communication must be elevated to a higher standard. *See* Draft Memorandum, *supra* note 3, at 2.

[9] The Draft Memorandum suggests that the U.S. group solvency structure should enhance "broader access to information upstream and with regard to all holding company groups with regulated insurance entities and all affiliates in all tributaries." Draft Memorandum, *supra* note 3, at 2.

President Susan Voss emphasized the importance of the GSI Working Group's objectives when she reflected on the organization's experience with insurance companies and their holding entities, affirming that it "is not enough to focus solely on transactions with insurance companies."[11] Voss suggested that the insurance industry needed "to look through our "windows" and understand the contagions that could impact insurers," but to maintain "an appreciation of the "walls" in place when examining material exchanges between the insurers and other parts of the group" in order to safeguard the assets supporting policyholder obligations.[12]

II. THE AMENDMENTS TO THE INSURANCE HOLDING COMPANY SYSTEM REGULATORY ACT AND REGULATION CHANGE THE PLAYING FIELD FOR STATE INSURANCE COMMISSIONERS

Supervisory colleges are authorized under the NAIC's December 2011 Amendments to the IHCA Model Act (the "Amended Model Act"), the model statute governing control over and acquisitions of insurance companies.[13] Generally, the Amendments strengthen a state insurance commissioner's access to information so that he may better regulate group financial strength. They affect a greater sharing of regulatory information among states and countries where the affiliates of an insurer conduct business, with the parent company's central place of business designated as the lead regulatory authority. More specifically, the Amendments authorize multi-state coordination of regulatory filings, authorize insurance commissioners' participation in supervisory colleges, strengthen regulators' access to group affiliate information, and provide for the assessment of group financial strength upon initial application for control of a U.S. insurer.[14]

The implementation of supervisory colleges would not take away any of the state insurance commissioner's power to regulate and supervise the insurers or their affiliates within its jurisdiction—on the contrary, it would afford them more power than they previously had before the

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[10] *See* Draft Memorandum, *supra* note 3, at 3.

[11] *See* Statement of Susan E. Voss, *supra* note 1, at 8.

[12] *See id.*

[13] NAT'L ASS'N INS. COMM'RS, NAIC MODEL LAWS, REGS., AND GUIDELINES: INS. HOLDING CO. SYS. REGULATORY ACT § 7 (2011) [hereinafter MODEL ACT].

[14] *Id.* §§ 6-7. See, e.g., Campbell & Calbert, *supra* note 2, for a succinct summary of the Amendments.

Amendments to the IHCA. The Amendments provide for an insurance regulator, and in particular, a state insurance commissioner, to participate in a supervisory college with other regulators in order to better supervisor a domestic insurer that is part of a group with international operations, and to ensure the insurer is in compliance with the state code.[15]

Additionally, the Amendments make weighty changes to the ways in which state commissioners are empowered to oversee and examine not only domestic insurers, but also the insurer's holding company and its affiliates outside the commissioner's jurisdiction.[16] To facilitate the best use of these new powers, the Amendments provide for a state insurance commissioner's participation in Supervisory Colleges to enhance the regulation of insurers that are part of an insurance holding company system with international operations. The hope is that examination of the entire group's operations will enhance the commissioner's ability to ascertain the potential enterprise risks posed by the holding company system and affiliates to the domestic insurer. These changes can primarily be found in Sections 6 and 7 of the Amended Model Act.

First, Section 6 addresses the insurance commissioner's powers to obtain the information necessary to best examine an insurer. Section 6A grants state insurance commissioners the authority to examine insurance-company affiliates to "ascertain the financial condition of the insurer, including the enterprise risk to the insurer by the ultimate controlling party, or by any entity or combination of entities within the insurance holding company system . . . ."[17] "Affiliate" is defined in Section 1A of the Model Act to mean, "a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control

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[15] MODEL ACT, *supra* note 13, § 7; For a discussion of the Amendments, *see* Memorandum from Debevoise & Plimpton LLP to Clients, DEBEVOISE & PLIMPTON LLP (Apr. 6, 2011), *available at* http://www.debevoise.com/files/Publication/a096850b-2e74-40c1-a497-fbbca9cdce5c/Presentation/PublicationAttachment/d4fdb451-ac27-46fa-9906-2012904fabc4/NAIC2011SpringNationalMeeting.pdf; Daniel A. Rabinowitz, *NAIC Approval of "Supervisory College" Leaves Key Implementation Issues Unresolved,* 5 BLOOMBERG LAW REPORTS—INSURANCE LAW (2011), *available at* http://www.chadbourne.com/files/Publication/b0bfb51a-ff95-4b41-ba76-cfa397b83f16/Presentation/PublicationAttachment/19c14f19-e13c-4b4f-b2e4-da0bf56a7420/Rabinowitz_BloombergArticle_April11.pdf.

[16] MODEL ACT, *supra* note 13, § 6; *see also*, Rabinowitz, *supra* note 15 (discussing state insurance commissioner's expansion of powers).

[17] *Id.* § 6A.

with, the person specified."[18] Additionally, "enterprise risk" is defined in Section 1F of the Model Act to mean, "any activity, circumstance, event or series of events involving one or more affiliates of an insurer that, if not remedied promptly, is likely to have a material adverse effect upon the financial condition or liquidity of the insurer or its insurance holding company system as a whole."[19]

Section 6B explains how the commissioner may gain access to this necessary information for examination. Under Section 6B(1), the commission may order any insurer to, "produce such records, books, or other information papers in the possession of the insurer or its affiliates as are reasonably necessary to determine compliance."[20] If the commissioner deems such information necessary to determine compliance with the act, Section 6B(2) describes the procedure for obtaining information not in possession of the insurer.[21] The commissioner may order an insurer to, "obtain access to such information pursuant to contractual relationships, statutory obligations, or other method."[22] In the event that an insurer does not comply, or cannot obtain the requested information, the insurer must provide to the commissioner a detailed explanation of its reasons for failure.[23] The commissioner may then use his own discretion to determine whether the explanation is compelling, or whether it is without merit. Upon finding the explanation is without merit, after notice and hearing, the commissioner may then charge the insurer who failed to provide the information a penalty for each day of delay, or suspend or revoke the insurer's license.

Section 6E further extends how a commissioner may deal with an insurer that fails to produce documents, by providing the power, "to examine the affiliates to obtain the information," and "to issue subpoenas, to administer oaths, and to examine under oath *any person* for purposes of determining compliance with this section."[24] Failure to comply with a subpoena is punishable as contempt of court.[25]

These changes are significant because prior to the Amendments the commissioner's authority was considerably more restricted. A

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[18] *Id.* § 1A.
[19] *Id.* § 1F.
[20] *Id.* § 6B(1).
[21] *Id.* § 6B(2).
[22] MODEL ACT, *supra* note 13, § 6B(2).
[23] *See id.* § 6B(2).
[24] *Id.* § 6E (emphasis added).
[25] *See Id.*

commissioner could only examine an insurer's affiliates in the limited situations where, "the regulator had ordered the insurer to produce copies of books and records that were 'reasonably' necessary in order to determine compliance with laws, and [where] the insurer had failed to comply with such order."[26] The Amended Model Act "extend[s] the extra-territorial reach of state insurance regulators to examine and control insurance holding companies and insurers beyond their state borders."[27]

Second, Section 7 provides for a state insurance commissioner's participation in supervisory colleges. Under Section 7A of the Model Act, the Commissioner is granted, "the power to participate in a supervisory college for any domestic insurer that is part of an insurance holding company system with international operations in order to determine compliance by the insurer with this Chapter."[28]

Section 7C further clarifies what the commissioner's participation in the college will entail. This section provides that the commissioner may participate in a supervisory college "with other regulators" to assess the "business strategy, financial position, legal and regulatory position, risk exposure, risk management and governance process" as part of his examination process of individual insurers in accordance with Section 6.[29] "Other regulators" include those other "state, federal and international regulatory agencies," responsible for the supervision of the insurer and its affiliates.[30] Section 7C also gives the commissioner the power to enter into agreements with other jurisdictions' regulators to ensure cooperation, as long as those agreements are consistent with the confidentiality requirements provided in Section 8[31] of the Model Act.[32]

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[26] Rabinowitz, *supra* note 15 (citing NAT'L ASS'N OF INS. COMM'RS, MODEL LAWS, REGS., AND GUIDELINES: INSURANCE HOLDING COMPANY SYSTEM REGULATORY ACT § 440-1 (1993)).

[27] Mary Jane Wilson-Bilk et al., *United States: NAIC Proposes Expansive New Governance, Risk Management and Reporting Duties on Insurance Holding Company Systems; A New Liability Profile Emerges for Directors and Senior Management*, SUTHERLAND ASBILL & BRENNAN LLP 1 (July 26, 2010), http://www.mondaq.com/unitedstates/article.asp?articleid=105416 (discussing development of the Amendments).

[28] MODEL ACT, *supra* note 13, § 7A.

[29] *Id.* § 7C.

[30] *Id.*

[31] *Id.* § 8 (discussing confidential treatment of information obtained by the commissioner in the course of an examination).

[32] *Id.* § 7C.

Additional Amendments of interest include the requirement that a holding company report its Enterprise Risk at least annually on the newly created "Form F."[33] Form F, originally discussed as a supplement to Form B, requires the ultimate controlling person of an insurer to file an annual report with the state commissioner, identifying material risks within the holding company system that could pose financial and/or reputational "contagion" to the insurer.[34] The form outlines ten areas of a holding company's operations which could potentially pose Enterprise Risk to an insurer, including items such as: business plans of the insurance holding company for the next twelve months, identification of material concerns of holding company raised by supervisory colleges, and identification of any negative movement with rating agencies.[35]

Section 8A, Confidential Treatment, of the Amended Model Act authorizes the commissioner to use the "documents, materials or other information in the furtherance of any regulatory or legal action brought as part of the commissioner's official duties. The information contained in Form F would fall under this description. As such, the commissioner would be within his boundaries to share such information with members of a supervisory college, including foreign regulators.[36] To ensure compliance with all the adopted revisions, it is likely the NAIC will modify their current accreditation standards to guarantee State implementation of the changes into their respective insurance holding company acts.

III. INTRODUCTION TO AN OVERVIEW OF SUPERVISORY COLLEGES

Succinctly put, "supervisory colleges are groups of regulators from different countries that work together to oversee large cross-border

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[33] Anthony Roehl, *NAIC Adopts Revised Holding Company System Model Act Requiring Enterprise Risk Disclosure*, MORRIS MANNING & MARTIN LLP (Mar. 23, 2011), http://www.mmmlaw.com/media-room/publications/newsletter/ naic-adopts-revised-holding-company-system-model-act-requiring-enterprise-risk-disclosure.

[34] Wilson-Bilk et al., *supra* note 27, at 7 (discussing the Enterprise Risk Report in its preliminary context of the "Annual Report"). The Annual Report would have been a supplement to the existing Form B, but instead was made into its own Form F. *Id.*; *see also* Roehl, *supra* note 33.

[35] *See* Roehl, *supra* note 33; see also Wilson-Bilk et al., *supra* note 27, for a discussion of the Form F development.

[36] Wilson-Bilk et al., *supra* note 27, at 8.

financial organizations."[37] They are not decision-making bodies; rather, they are designed to share prudential information about cross-border institutions.[38] Supervisory colleges are also meant to supervise companies at the group level, rather than legal entity level.[39]

Supervisory colleges serve to provide a forum that facilitates a more comprehensive view of "all the activities of a multi-faceted, multi-jurisdictional enterprise that could present a systemic risk to the individual enterprise and the financial system as a whole.[40] They purport to act as a further element of an international framework for group-wide supervision, and function to provide a permanent forum for cooperation and communication between its involved members.[41] Furthermore, supervisory colleges operate as a mechanism to develop cooperation and exchange of information among involved supervisors,[42] and to coordinate supervisory activities on a group-wide scale under both baseline and worst-case scenarios.[43]

Proponents of supervisory colleges emphasize the numerous potential benefits the forums could bring to the insurance industry. Supervisory colleges would enhance supervisory cooperation and coordination of internationally active groups by providing a uniform forum for crisis management,[44] help to close regulatory gaps, and increase information flow between home and host supervisors.[45] As opposed to a temporary committee that is organized for a unique purpose in response to a crisis, supervisory colleges are flexible and permanent, enhancing cooperation and coordination among supervisory authorities.[46] They would assist in avoiding redundant work because of the expanded coordination

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[37] Wilson-Bilk et al., *supra* note 27, at 9.

[38] Duncan Alford, *Supervisory Colleges: The Global Financial Crisis and Improving International Supervisory Coordination*, 24 EMORY INT'L L. REV. 57, 78 (2010).

[39] Rabinowitz, *supra* note 15.

[40] Wilson-Bilk et al., *supra* note 27, at 9.

[41] INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS, *Guidance Paper on the Use of Supervisory Colleges in Group-Wide Supervision*, Guidance Paper No. 3.8, § 1, ¶ 14 (Oct. 2009) [hereinafter IAIS Guidance Paper].

[42] *Id.*

[43] *Id.* § 5.3, ¶ 62-72.

[44] *Id.* § 5.3.

[45] *Id.* § 5.1, ¶ 38; *see also id.* § 5.3, ¶ 63.

[46] *Id.* § 4, ¶ 34.

and communication, and would help to maintain the necessary levels of protection for policyholders.[47]

Supervisory colleges are also designed to contribute to the stability of financial markets overall.[48] Aggregated information may help to shed light on systemic risks that would not have been identified with an individual entity analysis. In particular, a supervisory college may be able to consider the impact of a particular group on the insurance industry, on other sectors of an economy, as well as any systemic risks the group may present.[49] Additionally, a supervisory college would facilitate information collection and analysis at the group level, including the compilation and analysis of information available on risk exposures, financial soundness, and governance of group entities.[50] This creates a forum for the insurer to provide clarity to the supervisors, with respect to its operations and strategy, at a group-wide, as opposed to an individual entity, level.[51]

The concept of supervisory colleges within the insurance sector is not entirely unique. Europe has employed similar concepts with coordinating committees and the United States has a process in place for supervisory cooperation across its state based regulation system.[52] In particular, the European Union has utilized colleges to supervise financial institutions operating in multiple Member States.[53]

Supervisory colleges would not replace entity level supervision; rather they would supplement that solo level supervision of single entities within a group, by using the exchange of information to coordinate supervisory activities on a group-wide basis.[54] Effectively, the operation of a supervisory college is based on mutual trust and confidence among the involved supervisors.[55] Functionally, supervisory colleges will work differently depending upon the circumstances of the group and the jurisdiction in which the group operates.[56]

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[47] IAIS Guidance Paper, *supra* note 41, § 5.3.

[48] *Id.* § 2.2, ¶ 28; § 5.2, ¶ 57.

[49] *Id.* § 5.1, ¶ 42, § 5.2, ¶ 57.

[50] *Id.* § 5.1, ¶ 42.

[51] *Id.* § 5.2, ¶ 60.

[52] *Id.* §1, ¶ 17.

[53] *See generally* Duncan Alford, *The Lamfalussy Process and EU Bank Regulation: Another Step on the Road to Pan-European Regulation?*, 25 ANN. REV. BANKING & FIN. L. 389 (2006).

[54] IAIS Guidance Paper, *supra* note 41, § 2.1, ¶ 19-21.

[55] *Id.* § 2.2, ¶ 25.

[56] *Id.* § 5.1, ¶ 46.

Supervisory colleges will be particularly useful because, as the IAIS guidance paper on the use of the colleges points out, "[t]here is a high level of divergence in the insurance industry regarding the nature of organisations [sic], the nature of regulation and supervision, and the development of markets and supervisory regimes in different jurisdictions."[57] Supervisory colleges are strongly recommended for insurance groups that operate in multiple jurisdictions.[58] More specifically, they are necessary where: "significant cross-border activities and/or intra-group transactions are conducted";[59] "effective group-wide supervision is essential to the protection of policyholders";[60] and, "effective group-wide supervision is essential to the financial stability of the market as a whole."[61]

IV. THE DISSEMINATION OF INFORMATION IN SUPERVISORY COLLEGES MUST BE CONSISTENT WITH THE APPLICABLE CONFIDENTIALITY REQUIREMENTS

A major concern with the use of supervisory colleges is ensuring that the dissemination of information is consistent with the applicable confidentiality requirements. It will be the group-wide supervisor's role to gather the relevant information, but it will also be his role to disseminate that information in accordance with the pertinent confidentiality agreements.[62] Because there is no global law or regulation on confidential information, this responsibility to handle sensitive information appropriately will fall solely to the individual supervisor and the college.[63]

Section 8 of the Amended Model Act discusses how a commissioner may use confidential documents, obtained in the examination process of an insurer, to assist in the performance of his duties. Amongst the included parties with which the commissioner may share this information, are members of a supervisory college. The section states that a commissioner, "may share documents, materials or other information, including the confidential and privileged documents, materials or information . . . with other state, federal and international regulatory agencies . . . including members of any supervisory college described in

[57] *Id.* § 6.1, ¶ 74.
[58] *Id.* § 6.1, ¶ 75.
[59] *Id.*
[60] IAIS Guidance Paper, *supra* note 41, § 6.1, ¶ 75.
[61] *Id.*
[62] *Id.* § 4, ¶ 36.
[63] *Id.* § 6.2, ¶ 102.

Section 7, provided that the recipient agrees in writing to maintain the confidentiality and privileged status of the document."[64] As previously discussed, Section 6 of the Amended Model Act provides for a commissioner to gain access to extensive information from both an insurer and its affiliates as long as he deems it required for an accurate examination.[65]

These confidentiality agreements should touch upon when and what information can be disclosed to third parties and the insurance group.[66] Pertinent parties could include local supervisory/regulatory bodies, international organizations, or the public where appropriate.[67] Agreements should also lay out any differences in the confidentiality requirements of information sharing during a normal basis, and sharing during a crisis situation.

Despite the college's reliance on supervisors laying all known information on the table, in certain circumstance, a "'need to know' basis" for information sharing may be appropriate.[68] Such restrictions would

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[64] MODEL ACT, *supra* note 13, § 8C(1) (additionally providing that the recipient of such information in a supervisory college has "verified in writing the legal authority to maintain confidentiality").

[65] *Id.* § 6.

[66] The Basel Committee's *Good Practice Principles on Supervisory Colleges,* recommends what to do before passing confidential information received from a fellow supervisor to a third part with a legitimate interest, as well as what to do in the event that a supervisor is legally compelled to disclose such information. Basel Committee on Banking Supervision, *Good Practice Principles on Supervisory Colleges* (Oct. 2010), at 22. First, in the event of a legitimate third party request for confidential information, the Basel Committee recommends that, "[p]rior to passing information to the third party, the recipient should consult with and seek agreement from the supervisor that originated the information, who may attach conditions to the release of information, including whether the intended additional recipient is or can be bound to hold the information confidential." *Id.* Second, in the event that a supervisor is legally compelled to disclose information obtained confidentially to a third party, including a third party supervisory authority, the Basel Committee recommends that, "information that has been provided in accordance with a statement of mutual cooperation, [the supervisor that has been legally compelled to disclose] should promptly notify the supervisor that originated the information, indicating what information it is compelled to release and the circumstances surrounding its release." *Id.* In all instances, the supervisor disclosing the information should use his best efforts to maintain the confidentiality of the information to the extent permitted by law. *Id.*

[67] IAIS Guidance Paper, *supra* note 41, § 5.3, ¶ 73.

[68] *Id.* § 5.3, ¶ 65.

likely be dictated in previously drafted confidentiality agreements to avoid unintended turmoil. For instance, during a crisis, the premise of widespread information may need to be limited to ensure timely responses.

The timing and content of information to be disclosed to third parties must also be deliberated carefully. Group-wide supervisors may find it wise to establish appropriate contacts with other sector participants, but they must consider their existing relationships within the college, and weigh these relationships against the potential value of the information additional new members may be able to provide.[69]

Members must also be aware of any existing legal or jurisdictional restraints. Supervisory colleges do not override the various individual jurisdiction's' legal responsibilities or standing supervisory relationships.[70] Where there are legal constraints to information sharing in a particular jurisdiction, supervisors looking to participate in the college should address these constraints to maintain the effectiveness of the college.[71] Ultimately, a supervisory college will need to safeguard against any plan going beyond the authority of a supervisor, or surpassing any jurisdiction's existing legal framework.[72]

An alternative method of confidentiality to a traditional confidentiality agreement is a Memorandum of Understanding ("MoUs"). MoUs are information sharing agreements that ensure confidentiality and define the parameters in which information can be used.[73] They are formal statements of mutual cooperation that outline procedures and provisions for confidentiality.[74] A MoU should recognize that information must be shared between the relevant authorities in two countries in order to facilitate effective consolidated supervision of institutions that operate across their national borders.[75]

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[69] *Id.* § 4, ¶ 37.

[70] *Id.* § 5.1, ¶ 40.

[71] *Id.* § 6.1, ¶ 77.

[72] *Id.* § 6.2, ¶ 80.

[73] IAIS Guidance Paper, *supra* note 41, § 5.2, ¶ 54.

[74] Basel Committee on Banking Supervision, *supra* note 66, at 20. The publication further emphasizes that MoUs must be underpinned by, "trust and a network of relationships that are required for effective information sharing, particularly where confidential information is concerned." *Id.*

[75] Additionally the MoU between the two countries should recognize the practice of information sharing in order to facilitate "solo supervision of group entities in the host jurisdiction." *Id.* The Basel Committee identified information sharing to be "contact during the authorisation [sic] and licensing process, during

Jurisdictions that are part of the International Association of Insurance Supervisors Multilateral Memorandum of Understanding on Cooperation an Information Exchange ("IAIS MMoU") are required to have their legislative regimes assessed to ensure strict confidentiality requirements are met as a precondition for joint supervisory activity.[76] If each member of the supervisory college were a part of the IAIS MMoU, there would be no need for individual bilateral MoUs between the members.[77] The IAIS MMoU allows regulators in different countries to work together in overseeing insurers, and it has 17 jurisdictions—though currently none are US regulators.[78] A subgroup of the NAIC's SMI Task Force working on the issue of supervisory colleges was given the task of surveying state laws to better see if states could participate in the IAIS MMoU.[79]

V. THE FEDERAL INSURANCE OFFICE'S AUTHORIZATION OF THE UNITED STATES PARTICIPATION IN COVERED AGREEMENTS AND THE POTENTIAL FOR PREEMPTION OF STATE LAWS

The Federal Insurance Office ("FIO") Act authorizes the United States to jointly negotiate and enter into Covered Agreements with foreign governments, authorities, or regulatory bodies, and once entered into, authorizes the FIO to preempt a state insurance measure that conflicts with the Covered Agreement.[80] A Covered Agreement is defined by the Act to be "a written bilateral or multilateral agreement regarding prudential measures with respect to the business of insurance," entered into between

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supervision of ongoing activities and during the handling of problem institutions." *Id.*

[76] IAIS Guidance Paper, *supra* note 41, § 5.2, ¶ 54.

[77] *Id.* § 6.2, ¶ 103.

[78] Matthew Sturdevant, *Connecticut Insurance Regulators Join Forces With Swiss Counterparts*, HARTFORD COURANT (Sept. 23, 2011), http://blogs.courant.com/connecticut_insurance/2011/09/connecticut-insurance-regulato-1.html.

[79] *NAIC Pursues International Agenda*, NAIC UPDATE (Deloitte LLP), Spring 2010, at 7.

[80] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 502, 124 Stat. 1376, 1587 (2010). A "state insurance measure" is defined by the Act to include "any State law, regulation, administrative ruling, bulletin, guideline or practice relating to or affecting prudential measures applicable to insurance or reinsurance." *Id.*

the United States and a foreign entity that relates to the business of insurance in order to achieve a level of protection "substantially equivalent" to that received under State regulation.[81] This means that the covered agreement must effectuate at least the same level of protection for insurance consumers as they receive under state regulation.[82] This preemption provision is awakened when a state measure is inconsistent with a Covered Agreement, and produces less favorable treatment for a non-U.S. insurer whose domiciliary jurisdiction is party to the Agreement.[83]

Imagine a situation where a state joins a supervisory college with a non-U.S. member, and that state shares confidential information with the foreign entity. If that foreign entity were to share that information with its government, and that foreign government were to decide it did not like what it saw, it could potentially used the information obtained from the supervisory college as leverage to wrangle the U.S. into a Covered Agreement that afforded the foreign government's insurers more protection/similar treatment by a state that was previously afforded. Presented with this new information, the U.S. government may feel pressured into a Covered Agreement. This may not be a bad thing, and the scenario is grossly obscure and unspecific, but should it be decided that the state measure now violates the new Covered Agreement and must be preempted, the state may be worse off than it was before participating in, and sharing information with, the supervisory college. The chances of this

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[81] *Id.* More specifically, the covered agreement may be entered into between the United States and "one or more foreign governments, authorities, or regulatory entities." *Id.* Additionally, the agreement must employ "prudential measures" in achieving said level of protection for insurance consumers. *Id.*

[82] The phrase "substantially equivalent to the level of protection achieved" is defined by the Act to mean that, "the prudential measures of a foreign government, authority, or regulatory entity achieve a similar outcome in consumer protection as the outcome achieved under State insurance or reinsurance regulation." § 502, 124 Stat. at 1587. *See e.g.*, Statement of Susan E. Voss, *supra* note 1, at 7. Voss additionally pointed out that the FIO does not have general supervisory or regulatory authority over the business of insurance, but that the NAIC was willing to work with the FIO in terms of suggestions for improvements. *Id.* at 7-8.

[83] § 502, 124 Stat. at 1583 ("A State insurance measure shall be preempted pursuant to this section or section 314 if . . . the measure—(A) results in less favorable treatment of a non-United States insurer domiciled in a foreign jurisdiction that is subject to a covered agreement than a United States insurer domiciled, licensed, or otherwise admitted in that State; and (B) is inconsistent with a covered agreement.").

happening, if at all, are most likely few and far between, but states should be aware of the potential consequences that the FIO's preemption provision could have, when it is examined in conjunction with the role of foreign governments and their possible access to confidential information through supervisory colleges.

VI. CONNECTICUT AS A CASE STUDY FOR RECENT DEVELOPMENTS IN STATE INVOLVEMENT WITH SUPERVISORY COLLEGES AND INTERNATIONAL MEMBERS

Connecticut Insurance Commissioner Thomas B. Leonardi has been a proponent of the proposals recommended by the NAIC for the Amended Model Act since his appointment in February 2011. According to Commissioner Leonardi, "The model Holding Company Act would allow everyone to come to the table together, share information in a unique way, and would inevitably lead to more collaboration and cooperation in the insurance market."[84]

Although Connecticut has not yet officially adopted the changes into its insurance holding company system act, the state has made several moves towards international coordination and supervision. A recent agreement between the Connecticut Insurance Department and the Swiss Financial Supervisory Authority provides for both parties to work together to regulate insurers.[85] The Connecticut Courant reported that, "A memorandum of understanding between the two is the formal basis for cooperation and coordination, including investigative assistance and the exchange of information, [according to] Donna Tommelleo, the insurance department's spokeswoman."[86] The Courant additionally reported statements by Connecticut Insurance Commissioner Leonardi saying that: "'The insurance industry is an international one and continues to expand its global reach . . . . Regulating it cannot stop at the border and must be looked at in its totality. This commitment will allow Connecticut and Swiss regulators to work effectively together and ensure market stability for consumer protection.'"[87]

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[84] Pullman & Comley LLC, *A Conversation With Connecticut's New Insurance Commissioner Thomas B. Leonardi*, CT INS. LAW UPDATE, 2, http://www.pullcom.com/news-publications-277.pdf (last visited Oct. 2, 2012).

[85] Sturdevant, *supra* note 78.

[86] *Id.*

[87] *Id.*

Connecticut also has an agreement already in place with De Nederlandsche Bank in the Netherlands which is similar to the one between the state and Switzerland.[88] In addition to Switzerland and the Netherlands, Connecticut has a third agreement pending with the Germany Federal Financial Supervisory Authority ("BaFin").[89] The agreements with these countries in particular were pursued because Swiss Re and Munich Re are examples of companies that have a presence in Europe and Connecticut.[90] Furthermore, Connecticut's Insurance Department is one of at least two states that have applied to be a part of the IAIS MMoU on Cooperation and Information Exchange.[91]

VII. THE NAIC'S FACILITATION OF US AND INTERNATIONAL REGULATOR PARTICIPATION IN SUPERVISORY COLLEGES, AND OTHER DEVELOPMENTS IN THE INSURANCE SECTOR WORKING TOWARDS INTERNATIONAL COORDINATION

Within the last year the NAIC took serious steps to facilitate states participation in supervisory colleges. The NAIC recently created an online form that allows international regulators to request a particular State's participation in an international supervisory college.[92] The "International Supervisory Colleges Request Form" is submitted to the insurance group's appropriate leader and/or domestic supervisor who in turn will contact the international regulator directly.[93]

Former NAIC President Susan E. Voss, is quoted on the NAIC website as saying,

> U.S. insurance regulators recognize the important role supervisory colleges can play in providing a forum to foster improved international communication and coordination regarding the

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[88] *Id.*

[89] *Id.*

[90] *Id.*

[91] Sturdevant, *supra* note 78. See discussion of IAIS MMoU on Cooperation and Information Exchange *supra* p. 163.

[92] Nat'l Ass'n of Ins. Comm'rs, *NAIC Develops International Supervisory Colleges Request Form* (Mar. 18, 2011), http://www.naic.org/Releases/2011_docs /international_request_form.htm (announcing the web-based tool to facilitate coordination of US insurance regulators' participation in supervisory colleges).

[93] *Id.*

> oversight of significant global insurance operations . . . . We hope this web-based tool will aid international regulators to promptly notify the appropriate U.S. state insurance regulators regarding a particular supervisory college and secure the appropriate representation.[94]

Furthermore, supervisory colleges are not the only way the NAIC and the IAIS are working towards international supervisory coordination. There are two other significant solutions worth mentioning: one, the Supervisory Forum; and two, the "Common Framework for the Supervision of Internationally Active Insurance Groups" ("ComFrame"). The NAIC chairs the Supervisory Forum at the IAIS.[95] In addition to the increased use of supervisory colleges, state regulators are advocating the use of the Supervisory Forum to improve coordination.[96] Former NAIC President Susan E. Voss described the objective of the Supervisory Forum as a way "to strengthen the effectiveness of insurance supervision and to foster convergence of supervisory practices through the exchange of real-world experiences."[97]

First proposed by the IAIS,[98] ComFrame lays out how supervisors around the globe can work together to supervise internationally active insurance groups.[99] The GSI Working Group is aiding in this project by providing its own insight on how to identify internationally active insurance groups, and how to resolve jurisdictional issues.[100] Participation in the development of ComFrame is an effective way for the GSI Working Group to further its original task to find a method of supervision that will allow state insurance regulators to monitor the combined capital adequacy of all entities within an insurance holding company system, including internationally active insurers.[101]

There has been some concern that ComFrame would not be consistent with NAIC principles of state autonomy. The GSI Working Group responded to this concern by stating that, "given the uniqueness and

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[94] *Id.*

[95] Statement of Susan E. Voss, *supra* note 1, at 189.

[96] *Id.*

[97] *Id* at 189-90 (comparing the Supervisory Forum as akin to the multi-jurisdictional coordination framework that the United States uses).

[98] DEBEVOISE & PLIMPTON LLP, *supra* note 15, at 4.

[99] *Id.*

[100] *Id.*

[101] *Id.*

complexity of large insurance group issues, ComFrame should focus on general principles and high-level concepts, rather than specific compliance issues and capital requirements that more likely would be a source of conflict."[102] Former NAIC President, Susan Voss, further characterized ComFrame as a "multijurisdictional" approach to supervision.[103] She stated that, "If done right, ComFrame has the potential to create a multijurisdictional approach to supervision that emphasizes robust oversight and cooperation while maintaining the proper balance between home and host jurisdictions."[104]

VIII. POTENTIAL OBSTACLES AND CONCERNS PRESENTED BY SUPERVISORY COLLEGES

The design of a supervisory college turns on the assumption that all regulators will have the goal of group solvency and stability above all in mind. This may not be the case. Each individual regulator may be more focused on his own relevant market or sector in his own country or state.[105] In addition to a lack of consistency between regulator's jurisdictional goals, there may also be an inconsistency within groups themselves. Entity-level risks vary within a group, and regulators may not agree on how each individual entity should be treated.[106] These differing objectives can be illustrated through how different regulators "in favor" of different entities within a group, may want to treat the group's liquidity differently. Imagine a scenario where a U.S.-based insurance company is owned by a foreign entity. In this case, it is possible that the state insurance regulator will most want to keep capital with the insurer, while the foreign holding company regulator will want it to flow up as dividends.[107] These inter-affiliate dividends are a potential "zero-sum" problem that could arise in a

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[102] *Id.* at 4-5 (explaining the GSI Working Group's response to such concerns); Susan Voss expressed a similar sentiment on ComFrame's limited purpose, when she said that it, "should neither be a platform for pushing a global capital standard for insurance, nor create prescriptive ways to promote a particular means for solvency standards, nor create additional layers of regulation." Statement of Susan E. Voss, *supra* note 1, at 178.

[103] *Id.* at 190.

[104] *Id.*

[105] Rabinowitz, *supra* note 15.

[106] *Id.*

[107] *Id.*

supervisory college,[108] and impede on the ultimate success of coordination and cooperation.

Supplemental to the above concern, is the potential for weakness due to a supervisory college's strong reliance on supervisor cooperation and trust. Because there is no mandatory mediation process to resolve supervisor disagreement on an action, supervisors are still legally free act on their own and not in coordination with their peers.[109] It is not a far-fetched argument to make that supervisors will first strive to protect their national interest, and the rights of the residents within their jurisdiction, before conceding to compromises that may not be in their jurisdiction's best interest. This focus could cause inconsistencies in resolutions if individual supervisors do not approach issues with the college's end goals in mind.

An additional concern is that the decision-making schemes for supervisory colleges are not consistent with the NAIC. In particular, there is concern that international supervisors may be more accustomed to one lead supervisor making the decisions, whereas the NAIC fosters a system of "consensus" decision-making.[110] The GSI Working Group has responded to such a concern by addressing the role of the "group supervisor" of a supervisory college, and affirming that such supervisor will primarily have a coordinating, rather than decision-making function.[111]

It has already been stressed that in recent years, international coordination has been an essential goal for the NAIC. Each project, solution, and suggestion the NAIC has proposed was ultimately made with the U.S. and global insurance industry's success in mind; however, it should be noted that opening doors in one area could leave potential holes in another. With this in mind, another potential concern resides in the NAIC's recently adopted "Own Risk and Solvency Assessment Model Act" ("ORSA") that requires an insurance company, or insurance group, to produce a self-risk assessment report that must be filed with the insurer's state insurance commissioner.[112]

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[108] *Id.*

[109] IAIS Guidance Paper, *supra* note 41, § 5.1, ¶ 40.

[110] DEBEVOISE & PLIMPTON LLP, *supra* note 15, at 5.

[111] *Id.*

[112] On September 12, 2012, the NAIC adopted the Draft version of the Model Act with some minor changes. The heart of ORSA, the "ORSA Summary Report," is detailed in Section 5 of the Model Act. It reads as follows: "[u]pon the commissioner's request, and no more than once each year, an insurer shall submit to the commissioner an ORSA Summary Report or any combination of reports that together contain the information described in the ORSA Guidance Manual,

Several concerns were raised at the NAIC's Spring 2011 meeting in regards to the proposed U.S. "ORSA" plan. One concern addressed confidentiality issues in particular, pointing out that information requested by the ORSA would have the potential to expose a company's competitive advantage because the document would contain models that included competitively sensitive and forward-looking information.[113] Should the ORSA reports ever be shared within a supervisory college in the future, this concern would literally be projected onto an international level. When considering whether to allow an ORSA report to be shared and discussed in a supervisory college, the benefit of potentially exposing a risk through a window into an insurance company's capital levels in light of its unique business strategy would have to be carefully weighed against the detriment if such valuable information were to be abused. However, this does not seem to be a major concern of the NAIC.

Section 8 of the ORSA Model Act discusses confidentiality, but not without many opportunities for sharing. After initially addressing that all information collected by commissioners will be recognized as being proprietary and to contain trade secrets, subsection A provides a caveat for disclosure: "However, the commissioner is authorized to use the documents, materials or other information in the furtherance of any regulatory or legal action brought as a part of the commissioner's official duties."[114] Subsection C(1) extrapolates the commissioner's ability to share information in order to assist the commissioner in the performance of his regulatory duties, and specifically addresses a commissioner's ability to share such confidential information within a supervisory college.[115] With

applicable to the insurer and/or the insurance group of which it is a member. Notwithstanding any request from the commissioner, if the insurer is a member of an insurance group, the insurer shall submit the report(s) required by this subsection if the commissioner is the lead state commissioner of the insurance group as determined by the procedures within the Financial Analysis Handbook adopted by the National Association of Insurance Commissioners." NAT'L ASS'N INS. COMM'RS. RISK MANAGEMENT AND OWN RISK AND SOLVENCY ASSESSMENT MODEL ACT, §§ 1, 5 (2012) [hereinafter ORSA MODEL ACT].

[113] DEBEVOISE & PLIMPTON LLP, *supra* note 15, at 5-6.

[114] ORSA MODEL ACT, *supra* note 112, § 8(A).

[115] ORSA Section 8(C)(1) provides in relevant part: "In order to assist in the performance of the commissioner's regulatory duties, the commissioner: May upon request, share documents, materials or other ORSA-related information, including the confidential and privileged documents, materials or information subject to subsection A, including proprietary and trade secret documents and materials with other state, federal and international financial regulatory agencies, including

this allowance for sharing, the NAIC is likely predicting scenarios where the ORSA Report becomes a substantial part of the Commissioner's evaluative and investigatory process when evaluating an insurance company that is within its jurisdiction. Section 8 further expands the commissioner's ability to share ORSA-related confidential information in supervisory colleges by including the complementary subsection C(2), which provides for a commissioner's ability to also *receive* confidential, ORSA-related materials while participating in a supervisory college forum.[116]

Abuse of confidential information obtained through ORSA-related materials may not manifest in a typical breach; however, members of a supervisory college may become privy to sensitive information that could alter their personal opinions as to whether they would choose to do business with a particular insurer in the future after gaining access to a report that literally outlines the company's greatest risks. The NAIC may implement endless provisions to ensure that the confidential nature of an ORSA Summary Report is legally upheld, but it would be impossible to control how such information could potentially influence each individual's private judgments. Despite group discussions within the forum, whether disclosure of a particular insurer's risks actually warrants such trepidation in future dealings will be a matter each member alone will ultimately decide.

Yet another concern lies with the Form A. Supervisory colleges' influences on Form A are yet to be determined. All acquisitions of insurance companies are subject to prior approval via submission of the Form A under the IHCA. Where a state regulator normally feels neutral towards an acquisition as long as the transaction does not affect policyholder protection or insurer solvency, other interested parties might have a more biased view of controversial terms, like the purchase price.[117] This could potentially pose a problem if the domiciliary regulator is part of a supervisory college with these other interested parties. For instance, the

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members of any supervisory college . . . ." ORSA MODEL ACT, *supra* note 112, § 8(C)(1).

[116] ORSA Section 8(C)(2) provides in relevant part: "In order to assist in the performance of the commissioner's regulatory duties, the commissioner: May receive documents, materials or other ORSA-related information, including otherwise confidential and privileged documents, materials or information, including proprietary and trade-secret information or documents, from regulatory officials of other foreign or domestic jurisdictions, including members of any supervisory college . . . ." ORSA MODEL ACT, *supra* note 112, §8(C)(2).

[117] Rabinowitz, *supra* note 15.

group that is selling its insurance entity will want to be sure that the purchase price is fair, and likely, is a smart deal. As such, the regulator representing the interests of this holding company may feel more inclined to frame the situation to the state commissioner in a light more favorable to the holding company.[118] This could pose problems in the form of unnecessary complexity during the Form A proceedings, as well as misguided decisions by state commissioners receiving biased advice.

Issues with inter-collegiate influence could cause problems of its own if the regulatory community decides to ostracize a particular commissioner that does not heed ill-motivated advice. If a domestic regulator proposed that the supervisory college was treating one of his domestic insurers too aggressively, they could run the risk of effectively excluding themselves from discussions henceforth. Furthermore, conflict at this level has the potential to affect not only the commissioner's personal status in the college, but also his domestic insurers if his fellow regulators choose to collectively lash out as a punishment. It is worth re-mentioning that participants in these colleges represent supervisors and regulators from jurisdictions across borders, as well as jurisdictions across sectors. How each participant is connected with one another is likely to be incestual at times, and these relationships could just as easily be exploited in a negative manner as they could be used to the college's advantage. Regulators are people, and congruency between people—especially those who don't choose to work together—is not a guarantee.

IX. THE ISSUE OF WHETHER SUPERVISORY COLLEGES ARE OUTSIDE 'BUSINESS OF INSURANCE' AS DEFINED IN THE MCCARRAN-FERGUSON ACT

A. THE 'BUSINESS OF INSURANCE' AS DEFINED IN THE MCCARRAN-FERGUSON ACT

There are potential legal challenges that arise with the new powers afforded to a state insurance commissioner under the Amendments to the IHCA. In particular, there are issues concerning whether a state insurance

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[118] *Id.*

commissioner's new powers are within the accepted definition of the "business of insurance" under the McCarran-Ferguson Act. Policing enterprise risk is outside the traditional realm of policyholder protection, and a commissioner's involvement in a supervisory college is more likely to focus on enterprise risks rather than policyholder interest.[119]

Put succinctly, the McCarran-Ferguson Act (hereafter "the Act") is the response by Congress to a Supreme Court decision that would have placed regulation of insurance in the hands of the Federal government pursuant to the interstate Commerce Clause.[120] The Act states that the "business of insurance . . . shall be subject to the laws of the several States which relate to the regulation or taxation of such business," and that "[n]o Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance."[121] As such, what is outside the "business of insurance," is outside the Act's immunity, and thus subject to Federal regulation.

The Supreme Court decided three major cases to shape the present day definition of what constitutes the "business of insurance" under the Act.[122] First, in *Security & Exchange Commission v. National Securities, Inc.*, the Court highlighted that the Act "did not purport to make the states supreme in regulating all activities of insurance *companies*; its language refers not to the persons or companies who are subject to state regulation, but to laws 'regulating the *business* of insurance.'"[123] The case involved a merger between two insurance companies that the state insurance commissioner believed to be fraudulent and borne from ill intent.[124] The commissioner argued that if the Securities Exchange Act were to apply, it would supersede the state laws in place; however, the SEC argued that there was no conflict between the state and federal law, because the applicable state statutes did not give the state insurance commissioner the power to determine whether the interested parties in the merger had made full disclosure.[125]

The court held that it did not believe that "a state statute aimed at protecting the interests of those who own stock in insurance companies

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[119] *Id.*

[120] 1 LEE R. RUSS ET. AL., COUCH ON INSURANCE 3D § 2:4 (2009).

[121] 15 U.S.C. § 1012 (2006).

[122] 2 JOYCE PALOMAR, TITLE INS. LAW § 15:4 (2011).

[123] SEC v. Nat'l Sec., Inc., 393 U.S. 453, 459 (1969) (emphasis in original).

[124] *Id.* at 455. According to the amended complaint, National Securities had concocted a fraudulent scheme that centered around a merger between a insurance company they controlled and a second insurance company. *Id.*

[125] *Id.* at 457.

comes within the sweep of the McCarran-Ferguson Act."[126] Therefore, the court held that such a statute was not an attempt to regulate with 'business of insurance' as the phrase is used in the Act.[127] The Court went on to distinguish the 'business of insurance' from the activities of insurance companies in general, by narrowing the scope of the definition to concern only those statutes aimed at protecting the relationship between the insurance company and the *policyholder*.[128] Because the activity in question involved the insurance company's relationship with its stockholders, not its policyholders, the court found that such activity was not within the 'business of insurance.'[129]

In the second major case, the Supreme Court in *Group Life and Health Insurance v. Royal Drug Co.* proposed a three-prong test to determine whether an activity falls within the Act's scope of the 'business of insurance.'[130] This test is still used by courts today. The facts of *Royal Drug* concerned agreements between the insurance company and local pharmacies, requiring the insured to pay only $2 for prescription drugs.[131] The Court began its examination of whether these agreements were within the Act's business of insurance by emphasizing what had already been decided in *National Securities*—that the 'business of insurance' was categorically distinguishable from the business of insurance companies. From here the Court's opinion laid out three key points of consideration when determining whether an activity falls within the business of insurance. First, the Court determined that the "significance of underwriting or spreading of risk [is] an indispensible characteristic of insurance."[132] The insurance company argued that these agreements fell within the scope of 'spreading risk' because such agreements would reduce the premiums policyholders would have to pay in the long run.[133] The Court adamantly disagreed with this argument and held that:

> By agreeing with pharmacies on the maximum prices it will pay for drugs, Blue Shield effectively reduces the total amount it must pay to its

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[126] *Id.*
[127] *Id.*
[128] *Nat'l Sec., Inc.*, 393 U.S. at 460.
[129] *Id.*
[130] PALOMAR, *supra* note 122.
[131] Grp. Life & Health Ins. Co. v. Royal Drug Co., 440 U.S. 205, 207 (1979).
[132] *Id.* at 212.
[133] *Id.* at 214.

> policyholders. The Agreements thus enable Blue Shield to minimize costs and maximize profits. Such cost-savings arrangements may well be sound business practice, and may well inure ultimately to the benefit of policyholders in the form of lower premiums, but they are not the 'business of insurance.'[134]

Because the arrangements with the pharmacies did not spread policyholder risk, they did not satisfy the first prong.

Second, the Court extrapolated that Congress' primary concern in enacting the Act was, "'[t]he relationship between insurer and insured, the type of policy which could be issued, its reliability, interpretation, and enforcement-these were the core of the 'business of insurance.'"[135] It then held that the cost-saving effect the agreements produced for policyholders was not enough to satisfy the second prong's insurer-insured relationship standard.[136] The Court then again stressed the difference between the 'business of insurance' and the business of the insurance company, stating that if activity such as the agreements in question were deemed included, then almost every business decision of an insurance company could be included in the 'business of insurance[,]'" and that "[s]uch a result would be plainly contrary to the statutory language."[137]

Finally, the Court in *Royal Drug* consulted a brief legislative history of the Act, concluding that Congress intended to shield intra-industry cooperative rate making from anti-trust laws because such activity was essential to underwriting risks accurately.[138] Staying true to this intent, the Court held that, "[t]here is not the slightest suggestion in the legislative history that Congress in any way contemplated that arrangements such as the Pharmacy Agreements in this case, which involve the mass purchase of goods and services from entities outside the insurance industry, are the 'business of insurance.'"[139] As such, the last prong of the *Royal Drug* test

[134] *Id.*
[135] *Id.* at 215-16 (quoting *Nat'l Sec*., 393 U.S. at 460).
[136] *Royal Drug Co.*, 440 U.S. at 216.
[137] *Id.* at 217.
[138] *See id.* at 220-25 (discussing the history of Congress's original intent for enacting the Act).
[139] *Id.* at 224.

requires courts to consider whether parties are wholly within the insurance industry.[140]

The last chief case where the Supreme Court revisited the question of what comprised the 'business of insurance,' was *Union Labor Life Insurance Co. v. Pireno*.[141] In *Pireno*, the Court examined whether the use of a peer review committee to determine if a chiropractor's treatments were unnecessary, or his rates unreasonable, was not within the 'business of insurance,' and thus not exempt from antitrust scrutiny.[142] The Court concluded that the peer review committee failed all three prongs of the *Royal Drug* test, and thus was outside the 'business of insurance.' In regards to the third prong of the test, whether the involved parties were wholly within the insurance industry, the Court stated that such a failure alone need not deny the anti-trust exemption, but that "the involvement of such parties, even if not dispositive, constitutes part of the inquiry mandated by the *Royal Drug* analysis."[143] More generally, the Court refined the test by asserting that none of the three elements alone are determinative of whether an activity is within the 'business of insurance'; rather, all three elements must be taken together to form a collective picture.[144]

These three cases left strong themes for future courts to consider, most notably, that the 'business of insurance' is not synonymous with the business of insurance companies. In regards to supervisory colleges, the present concern proponents of the colleges should consider, is whether the new power of a state insurance commissioner to examine not only domestic insurers, but also affiliates, and to subsequently share such information with other regulators, is within the boundaries set by this definition. If the activities and information sharing engaged in under supervisory colleges are considered outside the 'business of insurance,' there inevitably arises a corresponding argument that supervisory colleges are outside the power of states' regulation, and are perhaps more appropriately situated under the jurisdiction of the Federal government.

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[140] *Id.*

[141] PALOMAR, *supra* note 122, at 20.

[142] *See* Union Labor Life Ins. Co. v. Pireno, 458 U.S. 119, 136 (1982) ("[Union Labor Life Insurance Co.]'s use of [New York State Chiropractor Association]'s Peer Review Committee does not constitute the 'business of insurance' within the meaning of § 2(b) of the McCarran-Ferguson Act, and thus is not exempt from antitrust scrutiny.")

[143] *Id.* at 133.

[144] *Id.* at 129.

A Supreme Court of Nebraska case concerning the acquisition of a domestic insurer by a foreign holding company provides an exemplary discussion of how courts have since muddled the lines of the *Royal Drug* test. Furthermore, the Court's holding that a state statute providing for its insurance department to approve the acquisition of control of any domestic insurer pursuant to its Insurance Holding Company System Act is within the boundaries of the McCarran-Ferguson definition of 'business of insurance,' is a strong argument that the new Amendments to the NAIC's IHCA do not trigger scrutiny of the Amendment's validity under the Act.

In *CenTra, Inc. v. Chandler Ins. Co., Ltd.*, Nebraska's Insurance Holding Company System Act required applicants looking to acquire a domestic insurance company to file a "Form A," but the Act allowed an acquiring party to avoid the insurance department's scrutiny by filing a disclaimer of control.[145] CenTra, the foreign holding company in question, filed such a disclaimer.[146] The insurance department approved the disclaimer, but on the condition that CenTra cease to purchase the insurance company's stock.[147] In the following years, CenTra did not obey the order and continued to purchase the insurance stock from other stockholders until CenTra controlled 49.2 percent of the insurance company.[148]

CenTra next took steps to officially acquire the insurance company, but following submission of the Form A, and the Form A hearing, the insurance department denied the applicant's request.[149] The department supported its decision by reasoning that, the financial condition of applicants could jeopardize the financial stability of the insurer or prejudice its policyholders; that applicants' competence, experience, and integrity were such that their acquisition of the insurer would not be in the policyholders' best interests; and that the acquisition of the insurer was likely to be hazardous to the public.[150]

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[145] CenTra, Inc. v. Chandler Ins. Co., 540 N.W.2d 318, 324 (Neb. 1995).

[146] *Id.*

[147] *Id.* ("CenTra filed such a disclaimer in 1989, and the department approved the disclaimer subject to CenTra's voluntary 'Standstill Agreement' to cease its stock purchases.").

[148] *Id.* (stating that upon learning of CenTra's actions, the Nebraska insurance department issued two "cease and desist" orders to CenTra).

[149] *Id.* at 325 (explaining that despite CenTra's prior disclaimer of control, the Form A would have become relevant again upon renewal of CenTra's acquisition efforts).

[150] *Id.*

The Supreme Court of Nebraska employed the three-prong 'business of insurance' test to determine "whether a restriction on the sale of stock in a domestic insurer is sufficiently connected to 'the business of insurance' to be shielded by the MFA from Commerce Clause attack," or whether this restriction, "intrudes impermissibly into the federal realm of securities regulation."[151] Under the first prong, the court held that, "the restriction on stock disposition relates, albeit indirectly, to the transferring and spreading of risk . . . . The Act affords the Director of Insurance a chance to review the financial stability of the acquiring company so that he can determine whether acquisition is in the best interests of Nebraska policyholders."[152] The court further found that the power of the director to "bring any threatened change of control under his own control" concerned policyholder protection because it allowed him to consider the impact such changes would have on policyholders.[153] Ultimately it held that whether a domestic insurer will remain reliable to its policyholders does relate to the transferring and spreading of risk, because a change of control can affect the quality and stability of policies.[154]

In discussing the second prong, the court found that the Nebraska Act satisfied the insurer-insured relationship requirement because the statute gives the director the power, ability, and statutory responsibility to ensure, "that the relationship between the insurer and the policyholder is one of mutual understanding and not one of deceit."[155] The court reconciled the indirect nature of their connection by broadly recognizing that, "the individual policyholder is not in a position to understand the ramifications of a change of control in his insurer until the insurer becomes insolvent and unable to pay claims."[156]

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[151] *CenTra, Inc.*, 540 N.W.2d at 330.

[152] *Id.*

[153] *Id.*

[154] *Id.* (citing Hoylake Invs. Ltd. v. Gallinger, 722 F. Supp. 573 (D. Ariz.1989) (applying Arizona law); Hoylake Invs. Ltd. v. Bell, 723 F. Supp. 576 (D. Kan.1989) (applying Kansas law); Hoylake Invs. Ltd. v. Washburn, 723 F. Supp. 42 (N.D. Ill.1989) (applying Illinois law)). The Nebraska court stated that these courts, in examining laws similar to the Nebraska statute in question, "reasoned that because a change of control of an insurer can affect the quality and stability of policies, these laws satisfy the requirement that they related to the transferring and spreading of risk." *Id.*

[155] *Id.* at 330-31 (citing *Bell*, 723 F. Supp. 576; *Washburn*, 723 F. Supp. 42).

[156] *CenTra, Inc.*, 540 N.W.2d at 330-31 (holding that the second prong of the 'business of insurance' test is satisfied).

Finally, the court found the third prong of the 'business of insurance' test to be satisfied as well. The court held that, despite the Act's effects on investors and stockholders seeking to own stock in Nebraska domestic insurers, and despite that the Act restricts when an out-of-state stockholder may sell his interest in the domestic insurer, because the ultimate focus of these restrictions remains with the individual policyholder, the statute still fell within the 'business of insurance.'[157] The court categorized those looking to acquire the insurance company as those "who wished to control the handling of CenTra's insurance claims . . . who sought to gain control of their insurer by owning its stock; and . . . who chose to cast into jeopardy the one policy concern for whose protection the department was created: that an insurer should remain as reliable as it promises its insureds it will be."[158]

Prior to concluding, the court went on to distinguish the present case from the issue presented in *National Securities*. Where the Court in *National Securities* held that, "regulation whose focus is the protection of stockholders does not sufficiently relate to the MFA to be shielded from Commerce Clause attack," the court in *CenTra* thought the present statute in question did not purport to protect stockholders as in *National Securities*; rather, the Nebraska Act was purely concerned with policyholders and had no stake in the "security of or services rendered to stockholders; whether merger or acquisition is equitable to stockholders is immaterial in the eyes of the director."[159] Furthermore, the court pointed out that the Court in *National Securities,* "found that the section of the Arizona act that empowered the director to determine whether acquisition would substantially reduce the security of *policyholders'* interests clearly relates to the 'business of insurance.'"[160]

B. ARGUMENT IN SUPPORT OF THE ADOPTED REVISIONS TO THE AMENDED MODEL ACT BEING WITHIN THE 'BUSINESS OF INSURANCE' AS DEFINED BY THE MCCARRAN-FERGUSON ACT

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[157] *Id.* at 331.
[158] *Id.*
[159] *Id.* (finding that despite the stockholder aspect of the Nebraska Act, the three-prong test to determine whether the statute satisfied the 'business of insurance' was satisfied).
[160] *Id.* (internal quotation marks omitted) (citing SEC v. Nat'l Sec., Inc., 393 U.S. 453, 462 (1969)).

If a court were to accept the fairly broad interpretation of the *Royal Drug* test from the *CenTra* holding, claims asserting that the Amendments to the IHCA are outside the 'business of insurance' would likely fail. Under *CenTra*, the extension of a state commissioner's oversight jurisdiction to out-of-state affiliates would satisfy the first prong of the *Royal Drug* test because the Amendments afford the commissioner, like Nebraska's Director of Insurance, a chance to review the financial stability of the holding company so that he can determine whether the group's health as a whole is in the best interests of the policyholders.

Similarly, under *CenTra* the commissioner's powers would pass the second prong, relating to the insurer-insured relationship, because the individual policyholder is not in a position to understand the ramifications of multi-jurisdictional supervision, and would not become aware of the risks until the insurer becomes insolvent and unable to pay claims.

Finally, the court in *CenTra* would most likely opine, despite the commissioner's power to reach outside of his jurisdiction, and, furthermore, to reach outside of the insurance industry per se by examining non-insurance affiliates, that the commissioner's actions were still ultimately for the benefit of the insurance industry.

This expansive reasoning is easily extended to a state's participation in supervisory colleges. Supervisory colleges are also provided for under the Amendments to the IHCA, and, under *CenTra,* a court would likely find that the activity fell within the 'business of insurance,' because the colleges are ultimately meant to benefit policyholders. Currently, the NAIC has put forth, "existing U.S. case law, [the] interests of other countries, and the renewed vigor that regulators enjoy . . . as a result of the 2008 crisis," as reasons why the new IHCA Amendments should still be upheld under the McCarran-Ferguson Act.[161] Justice Brennan once wrote that "'[t]he prevention of insolvency and the maintenance of 'sound' financial condition in terms of fixed-dollar obligations is precisely what traditional state regulation [of insurance] is aimed at.'"[162] However, should no opposition arise to supervisory colleges' validity under the McCarran-Ferguson Act's definition of the 'business of insurance,' this concern would be entirely moot.

C. ARGUMENT AGAINST THE ADOPTED REVISIONS TO THE AMENDED MODEL ACT BEING WITHIN THE 'BUSINESS OF

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[161] Rabinowitz, *supra* note 15.

[162] *CenTra, Inc.*, 540 N.W.2d at 331 (quoting SEC v. Variable Annuity Co., 359 U.S. 65, 90-91 (1959) (concurring opinion)).

INSURANCE' AS DEFINED BY THE MCCARRAN-FERGUSON ACT

Conversely, an alternative argument can be made for why the IHCA Amendments, particularly the state commissioner powers, and state's participation in supervisory colleges, do *not* fall within the accepted definition of the 'business of insurance.' Where the *CenTra* court took a very macro approach to the *Royal Drug* test, a more micro examination of the recent changes could be considered outside the accepted 'business of insurance' and more inside the business of insurance companies.

Challenges to the commissioner's cross-jurisdictional reach and participation in supervisory colleges, would likely be brought by a variety of interested parties. These opponents to the revisions have two potential grievances under which they may wish to challenge the Amended Model Act: one, the state commissioner's ability to demand insurance holding company systems and insurance affiliate information; and two, the authority for a state's participation in supervisory colleges.

The first group encompasses those opponents that are most unsettled by the ability of a state insurance commissioner to request sensitive information from whomever they deem relevant. An insurance holding company system's affiliates are wide ranging—some may be less willing than others to relinquish confidential information all in the name of international coordination. Affiliates that shelter information from their own regulators will be vehemently opposed to sharing such information with a state insurance commissioner.

The second group includes potential supervisory college members who may choose not to participate because they have certain risks they do *not* want to surface. The extensive information sharing environment a supervisory college fosters will create an ideal opportunity to unveil hidden perils. For some, this exposure may be exactly what they wish to evade. A successful challenge to the validity of supervisory colleges under the McCarran-Ferguson Act could result in the assurance that, at least while insurance remains under state regulation, information sharing across jurisdictional borders will be avoided.

It was previously discussed that supervisory colleges run the risk of fostering adverse relationships amongst regulators in response to members of the community that do not "go with the flow," so to speak. With the potential for these adverse relationships to escalate into adverse actions, may come feelings of ill will towards what was supposed to be a

harmonious solution to international coordination and supervision.[163] Shunned members pose a risk to the success of supervisory colleges as a whole if the injured parties decide their unfavorable experience with a college is indicative of its unruly powers. Ostracized regulators could challenge the validity of the Amendments under the McCarran Ferguson Act to ensure the supervisory college's failure. In this case, a regulator, whether domestic or otherwise, may not even be opposed to the state insurance commissioner's expansive powers; rather, he would be using the commissioner's cross-jurisdictional reach as an additional argument for the colleges' violative nature.

In *Pireno*, the court determined that the use of a state peer review committee to share information and make evaluations of its members was outside the business of insurance as defined by the McCarran-Ferguson Act.[164] The peer review board did not satisfy the first two prongs of the *Royal Drug* test because it did not spread policyholder risk, nor was it part of the insurer/insured relationship.[165] It is not a stretch to equate a supervisory college to a peer review board as a basis for a challenge against their validity. In *Pireno*, the committee worked together to determine whether a fellow chiropractor's treatments were unnecessary, or his rates unreasonable. In a supervisory college, members work together to determine whether a particular insurer, holding company system, or enterprise pose risks to global insurance stability. Both groups have the goal of a safer environment for their practice to thrive, and both groups share sensitive information to achieve that goal.

Additionally, a state's participation in a supervisory college, or a state commissioner's authority to access insurer affiliates, are both activities not wholly limited to entities within the insurance industry. A supervisory college involves regulators from a spectrum of sectors, and an insurer affiliate could literally be any entity affiliated with the operations of an insurance company. As such, it would not be a hard argument to make that the revisions in question to the Amended Model Act fail the third prong of the *Royal Drug* test as well.

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[163] It should be noted that the Basel Committee's guidance paper on supervisory colleges recommends that "any confidential information [exchanged between] supervisor[s] should be used exclusively for lawful supervisory purposes." Basel Comm. on Banking Supervision, *supra* note 66, at 22.

[164] Union Labor Life Ins. Co. v. Pireno, 458 U.S. 119, 134 (1982).

[165] *Id.* at 129-31.

X. CONCLUSION: SUPERVISORY COLLEGES WILL HELP FACILITATE INTERNATIONAL REGULATORY SUCCESS IN THE INSURANCE INDUSTRY

Supervisory Colleges are a way to enhance state based insurance regulation in an increasingly international environment. Where the concept of insurance companies as a completely independent entity is now more a legal fiction than reality, the success of supervisory colleges would help to appease those claims that a federal regulatory system is more adept to handle a global industry than the current state based system. States have expressed that they are willing to implement the necessary regulatory revisions to ensure that the positive track record of state-based insurance regulation continues to evolve with the changing times.[166] State commissioners view themselves not only as policemen of individual insurance companies, but also as stewards of highly interconnected financial systems.

The Amendments to the IHCA are only effective if adopted by individual state legislatures; however, the NAIC is moving to incorporate the changes into the required state accreditation standards, increasing the likeliness of states to comply. Even without the threat of losing its accreditation, already some states are beginning to adopt the recent revisions. West Virginia was first to make the changes to its own regulations in April of 2011, followed by Texas in June.[167] States like Connecticut haven't officially adopted the Amended Model Act as part of their insurance laws, but the state insurance commissioner is mimicking many of the changes the Model Act suggests on their own.

Those opposed to the Amended Model Act should move forward with caution. With the determination that the Model Act's revisions step outside state jurisdiction comes a corresponding argument that such powers should reside with the Federal government. Proponents for Federal insurance regulation could argue that the invalidity of state supervisory control in the international regulatory sector is indicative of the need for a more centralized approach to regulation—a more Federal approach. Banning state participation in supervisory colleges, and limiting a state

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[166] Statement of Susan E. Voss, *supra* note 1, at 7-8.

[167] Van R. Mayhall, III, *Form F and Enterprise Risk: NAIC Expands Regulatory Authority under the Model Insurance Holding Company System Regulatory Act,* BREAZEALE, SACHSE & WILSON, LLP (July 20, 2011), http://www.insuranceregulatorylaw.com/2011/07/form-f-and-enterprise-risk-naic-expands.html.

insurance commissioner's access to information, may prove to be a temporary dam that subsequently opens a floodgate of Federal regulatory power.

The creation of the FIO should be viewed as the first step in this direction. Even the FIO's description of the Office's function is alarmingly similar to what supervisory colleges set out to achieve. The FIO has the authority "to monitor *all aspects of the insurance industry*, including identifying issues or gaps in the regulation of insurers that could contribute to a systemic crisis in the insurance industry or the United States financial system."[168] Whereas states are limited to the McCarran-Ferguson Act's definition of the "business of insurance," the Dodd-Frank Act expands the federal government's reach to "all aspects of the insurance industry." Furthermore, the power for the Federal government to enter into a covered agreement with respect to the "business of insurance" with foreign parties should draw attention. Covered agreements touch three important points: one, the federal government; two, international parties; and three, the business of insurance. Alternatively, supervisory colleges touch nearly the same three points: one, state insurance regulators; two, international parties; and three, the business of insurance. A centralized regime could require international information sharing where no entity or enterprise would escape its reach.

Supervisory colleges are a step in the right direction for international regulatory success, and the provisions of the Amended Model Act that expand the state commissioner's power will help to facilitate success in a college forum. If not the state insurance commissioner, then it will be another regulatory body that will have access to affiliate information in order to best examine enterprise risk. States should move forward with their commissioner's participation, and opponents should mind that the alternative to colleges and extended commissioner power may prove to be even more evasive than option at hand.

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[168] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, tit. V, § 313(c)(1)(A), 124 Stat. 1376, 1580 (2010) (emphasis added).