

CHANGE IS HERE

As Obama comes to power, **Gavin Coull**, **John L. Jacobus** and **Gary Farmer** examine the changes the new regime could bring to the (re)insurance industry.

“Change can happen” was the rallying call during President Obama’s presidential campaign, but will it? As the US enters into its first new presidency in eight years, with a different political party in power and at a time of acute economic crisis, can we predict what impact the new regime will have on the insurance and reinsurance industry?

Government action and bail-outs with public funds will most certainly lead to changes in the law and regulations governing the US insurance industry, in all probability resulting in federal oversight. But outside the US borders, given Obama’s anti tax-loophole rhetoric, will the wider reinsurance marketplace be challenged by support for any reintroduction or restatement of the Neal bill (sponsored by U.S. Congressman Richard Neal), which sought to eliminate the perceived competitive disadvantage to US carriers of insurance written in the US being reinsured out into the more tax-friendly jurisdictions, in particular, Bermuda?

TAXING TIMES

The Neal bill, which was introduced in the US House of Representatives in September but died in Committee, sought to disallow currently permitted deductions for premiums paid out by companies reinsuring business written in the US into Bermudian affiliates. Rep. Neal was clear in his objectives – “I am pleased to come before the House

to introduce legislation ending the advantage of offshore reinsurance entities over American companies...” Supporters claim that this is anti-competitive; whilst opponents see it as rank protectionism. Given that Bermudian capacity bore the largest non-US market share of property catastrophe claims in recent years, there is a real risk that any such bill, while appeasing US domestic carriers will end up with that market assuming a greater percentage of loss exposure. There is much hard lobbying going on at present, and it remains to be seen whether, given the macro issues facing the US economy, such micro fiscal intervention will carry the day.

Federal regulation and oversight will arrive in some form and at some point during this presidency. Most insurance and reinsurance companies will welcome rational and consistent regulation, but the extent and manner of its implementation in the current climate and under a new presidential administration remain unknown. Less certain, though of no less impact for the wider reinsurance market, is whether inward-looking policies on tax treatment will form part of wider economic reforms. Bi-partisan politics or special interest lobbying may simply lead to “change for change’s sake” rather than “change for good” for both the US and international insurance community. One thing is certain, though – change is coming.

From left to right

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FEDERALISATION

Currently, the American insurance industry is regulated by each state in which an insurer operates, leading to multiple regulatory frameworks. How could federalisation operate?

OPTION 1

A "Federal Office of Insurance". On 23 January, two days after Obama's inauguration, several members of Congress (from both parties), supported by the American Insurance Association, wrote to Treasury Secretary Geithner proposing the creation of an oversight office within the Treasury department. They asked him "to fill a void on insurance oversight and expertise at the federal level" noting that "events in the insurance sector during the past 12 months have had a significant impact on the broader capital markets and economy;" and that "the apparent risk of a systemic shock to the broader economy was the reason behind the government intervention to prevent the collapse of American International Group". Creating an insurance oversight office in the Treasury is a relatively new idea; the extent of the authority it could wield is still unclear.

OPTION 2

A "Federal Charter". Many insurance industry groups endorse this option, which would allow insurance companies to choose between new federal regulation or to continue individual state regulation. Such federal regulation might include a guaranty fund to cover certain claims of insolvent insurers. Federal regulation should also lead to consistency of rules and regulations through a single body, as opposed to a company's striving to comply with the regulations of up to 50 different states. Federally chartered insurance companies would also have a strong voice and presence in Washington high in the executive branch that state-regulated companies currently do not have. But there is some suspicion of government oversight, with many companies reluctant to open up their books, risk management information, and sensitive financial data to yet another federal agency.

OPTION 3

A Federal Reserve Oversight Authority. This would put the Federal Reserve (or a newly-created, Fed-like government agency) in charge of protecting the entire financial sector, including insurance and reinsurance. This proposal has been introduced by Barney Frank, the chairman of the House Financial Services Committee, and would create a broad power "to gather information about the inner workings of banks, investment firms, insurance companies, hedge funds and any other entity big enough or so intertwined with other companies that it creates the risk of a systemic collapse". But it could also result in double regulation, on federal and state levels – which makes it doubtful insurance companies will line up in strong support. To date, the Obama administration has not commented on whether it supports this option.



Above Obama signs the \$32.8bn expansion of the State Children's Health Insurance Program (SCHIP) at the White House on 4 February. The SCHIP program aims to help families who cannot afford private health insurance but earn too much to qualify for Medicaid healthcare coverage for the poor. REUTERS/Kevin Lamarque (UNITED STATES)
Left Obama takes the oath of office, 20 January 2009. REUTERS