STRIKE ONE!

By Peter H. Bickford
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In one of its first opportunities to demonstrate that it "means what it says" by its stated objective "[t]o encourage, promote and assist banking, insurance and other financial services institutions to effectively and productively locate, operate, employ, grow, remain, and expand in New York state; . . ."[i] the new Department of Financial Services has taken a called Strike One!

In November 2011, the Superintendent of Financial Services, Benjamin Lawsky, issued a press release touting his newly issued regulation "to implement a law that deregulates most insurance business with large, sophisticated companies or public entities."[ii] In the release, Mr. Lawsky states that "[t]he new law and regulation enhance the ability of insurers to underwrite large commercial insureds in New York, increase speed to market for certain insurance products not currently exempted and eliminate barriers to economic development in New York." *Unfortunately, the effect of the new law and regulation on the marketplace are unlikely to match the rhetoric.*

A Bit of Background

For many years and over several administrations, the domestic New York insurance market, including insurers, brokers and their customers, have sought to ease the restrictions on providing unconventional or difficult to place coverages for sophisticated insurance consumers – primarily large commercial insureds that have the wherewithal and expertise to formulate and place their programs wherever they could find underwriting flexibility and competitive pricing to meet their needs. This usually meant using the surplus lines or offshore markets at the expense of domestic markets.

New York attempted to address this shortcoming in the late 1970s by adopting the "free zone" legislation[iii] and regulation,[iv] which allow domestic New York insurers the ability to write hard to place or large commercial risks free of restrictive rate and form filing requirements. While the "free zone" has been modestly successful over the years, critics often pointed to the high entry level (billed annual premium of $100,000 for one line of business), a cumbersome process of getting new hard to place lines "white listed," and for

the limitation that, although free from rate and form filing requirements, policy forms must comply with all and often irrelevant content requirements of the insurance law.

A new opportunity to address commercial deregulation was presented with the passage in 2010 of the Non Admitted and Reinsurance Reform Act, a part of the Federal Dodd-Frank legislation,[v] which set national standards for insuring "large commercial insureds" through the non-admitted or surplus lines markets, including a relatively modest $25,000 premium threshold and a comprehensive definition of risk management professionals.

The New Law

To keep pace with the new Federal law, New York lawmakers revised the Free Zone statute,[vi] particularly by making the Free Zone exemption from rate and form filing or approval requirements applicable to newly defined "large commercial insureds." However, the new law did not eliminate those requirements. Instead, the law required the insurer (i) to file a certificate of insurance "evidencing the existence and terms of the policy within one business day of binding the insurance coverage,"[vii] and (ii) to file any policy form to be filed "for informational purposes" within three business days of first use, or not later than 60 days after inception.[viii]

The addition of these filing requirements into an otherwise meaningful change was met with groans of disappointment from the industry and those who had thought the Legislature was finally willing to recognize the value and importance of loosening strict control of insurance for large, sophisticated commercial insureds. After this disappointment, it was hoped that perhaps the regulators, through the issuance of regulations to implement the new statute, would soften the effect of the legislation and increase the value of the changes. Not only has that not happened, but also *the concern is that the new regulation and accompanying circular letter make the statutory filing requirements so onerous as to make the new class of "free zone" risks close to useless!*

The New Regulation

The new regulation,[ix] issued as an emergency (i.e., no hearings) amendment to Regulation 86, Special Risk Insurance, adds a new class of business that can be written through the free zone for "a large commercial insured that employs or retains a special risk manager . . ." The definition of a large commercial insured and the requirements for

special risk managers substantially track the Federal Non Admitted and Reinsurance Reform Act definition and standards. In addressing the filing requirements of the NY statute, however, the regulation does little more than reiterate the statutory requirements. *The new regulation makes no effort to simplify or soften the burden or time frame for filings, and makes no effort to explain the "informational purposes" of filings or how regulators will actually use the filings.*

Would've, Could've, Should've . . .

Missed by regulators was the opportunity to demonstrate to the industry (and commercial purchasers) that they understand that the statutory restrictions make so-called commercial deregulation non-competitive and, therefore, highly unlikely to be of much use, if any, to the New York market. What could've been done? Although restricted by the language of the law, the regulation could have defined required filings narrowly, simplified filing content, and streamlined the process by, for instance, allowing bordereau filings on a periodic basis along with a insurer's certification of compliance and a commitment to maintain adequate records for any subsequent audit.

Also, regulators could have given some insight into how they intend to use data filed "for informational purposes." For instance, regulators could've made it clear that their primary goal was to use the data to determine whether or not the new free zone class of commercial risks adds a significant benefit to New York insurers, rather than to be used primarily as a means for enforcement of strict compliance.[x] Further, although the regulation gives insurers the ability to apply for hardship exemptions from electronic filing requirements, it gives no relief from strict filing timeframes, even under circumstances where the insurance placement is on a timetable that makes compliance impossible.

None of these approaches, of course, would be as effective as removing these unnecessary barriers altogether through a change in the law, but short of statutory changes regulators could've sent a signal that they were prepared to work with the industry and commercial insurance purchasers to find a way to make the new law an effective and meaningful tool.

Conclusion

The new amendment to the Free Zone regulation makes little effort to address the need for flexibility and timeliness for insurers seeking to compete with surplus lines or offshore markets for the business of large commercial insureds. Although not a total swing-and-a-miss in recognition of the fact that the NY regulators were limited by the wording of the statute adopted last Spring, the new regulation is still a negative in view of the lost opportunity to show that the regulators understand that large commercial insureds with qualified risk management capacity do not need the same restrictive and regimented regulatory oversight as, for instance, personal lines.

And large commercial insurance purchasers continue to have more flexible and responsive options through the non-admitted and offshore markets to the detriment of the domestic New York insurance industry!

Endnotes:

[i] Chapter 18-A of the Consolidated Laws of New York, Financial Services Law§102(a)

[ii] The Press release can be accessed on the Department of Financial Services website at http://www.dfs.ny.gov/about/press/pr1111211.htm

[iii] Article 63 of the New York Insurance Law, adopted in 1978.

[iv] New York Codes Rules and Regulations, Title 11, Insurance, Part 16, Special Risk Insurance (Regulation 86).

[v] Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

[vi] Chapter 490 of the Laws of 2011.

[vii] Insurance Law Section 6303 (a) (3) (B)

[viii] Insurance Law Section 6303 (a) (3) (C)

[ix] Third Amendment to 11 NYCRR 16 (Insurance Regulation 86), promulgated as an emergency measure on November 14, 2011. See also Department of Financial Services Insurance Circular letter No. 10 (2011) dated November 15, 2011 explaining the terms of the new regulation.

[x] This would logically fit with the fact that the statutory provisions creating the exemption for large commercial insureds sunsets June 30, 2013. See Insurance law Section 6303(a)(3).