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A Changing of the Guard:

***Policies, Programs and Court Appointments under
the Obama Administration and Their Potential
Effect on the Insurance and Reinsurance Industries***

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I. INTRODUCTION

The global economic crisis, together with the platform of “change” on which Barack Obama rose from first-term Senator to President of the United States, is likely to usher in a new era of government oversight and regulation in the United States. Today, much of the political debate and media focus in the U.S. is centered on reform of the nation’s healthcare system, a goal that is at, or near the top of, President Obama’s agenda. But reform is also taking shape in the areas of banking, financial services, utilities, industrial and manufacturing and, even, insurance. The White House and the Democratic majorities in both the Senate and House of Representatives are also calling for stronger consumer protection measures spurred on by the dramatic increase in mortgage and credit card defaults witnessed during the economic meltdown. Further, the U.S. is likely to see more vigilant enforcement actions by government agencies such as the Food and Drug Administration (“FDA”), the Securities and Exchange Commission (“SEC”) and the Environmental Protection Agency (“EPA”). In addition, an aging, and ailing, Supreme Court means that President Obama will likely appoint several new justices to the Court in the coming years, which may result in a more liberal Supreme Court. In fact, the Senate has recently confirmed President Obama’s nomination of Sonia Sotomayor -- considered by many to be both a liberal and a judicial activist -- as an associate justice of the Supreme Court.

Needless to say, there has been a noticeable shift in the political winds in the U.S. since the days of Republican President George W. Bush. The changes being proposed will, if they come to fruition, have both a direct and indirect impact on the insurance industry. The indirect impact may come in the form of increased claims by banks,

financial institutions, pharmaceutical companies, and industrial manufacturers, among others, that may be targeted by government enforcement actions and private lawsuits for which they will seek coverage under their D&O and liability policies. The direct impact to the insurance industry may come in the form of new federal legislation governing the regulation of both domestic and international insurers doing business in the United States. This would represent a shift from the traditional state regulation of insurance in the U.S.

While it can be said that the U.S. is currently moving to the left and to a more active government presence in business and industry, it remains to be seen how far to the left things swing and how much regulation is ultimately enacted. Already, there has been a backlash by both Congressional Republicans and a large segment of the American public over the size, scope and pace of “reform,” which has re-ignited debate in the U.S. on the scope of Constitutional powers accorded to the federal government. There is even dissent and bickering among Democrats, including more fiscally-conservative members of the party, as evidenced by the failure to pass a healthcare reform bill to date. It may not be until the 2010 mid-term Congressional elections that we see whether Obama-style “change” was a political mandate or, like many things in modern society, a passing fad.

II. PRESIDENT OBAMA AND THE SUPREME COURT

A president’s most lasting impact on the nation is sometimes felt in his judicial nominees who continue to serve on the federal bench long after the president has left office. Under the U.S. Constitution, the President is accorded the power to nominate justices to the Supreme Court, who must then be confirmed by the Senate before taking their seat on the high court. In the coming years, President Obama may have a rare opportunity to dramatically shape the composition of the Supreme Court and potentially

point it in a more liberal direction. No recent President has had such an opportunity: while President Richard Nixon appointed four justices in his five years in office, the next six Presidents combined to appoint only ten justices over the course of thirty-five years.¹

On 1 May 2009, just over three months into President Obama's term in office, Justice David Souter -- at age sixty-nine one of the youngest justices on the Supreme Court -- announced his retirement. On 6 August 2009, President Obama's nominee to replace Justice Souter -- federal appeals court judge Sonia Sotomayor -- was confirmed by the Senate in time for the beginning of the Supreme Court's 2009-2010 term. With only two new justices appointed to the Supreme Court from 1995 to 2008, the Supreme Court is becoming an old court, one likely to see a number of additional justices depart in the next several years.² Further, with at least four justices presently in their 70's, and Justice John Paul Stevens in his late 80's, it is likely that President Obama will get to nominate at least two more new justices in his first term alone, and possibly as many as five or six in a possible second term.³

As currently composed, the Supreme Court consists of four Justices -- Stevens, Ruth Bader Ginsburg, Stephen Breyer and Sotomayor -- who are considered liberal, and four Justices -- Antonin Scalia, Clarence Thomas, Samuel Alito and Chief Justice John Roberts -- who are conservative. Although he generally reaches conservative results more often than not, Justice Anthony Kennedy is considered the key "swing vote" on the Supreme Court and is more moderate than the other right-leaning justices. Liberal Court members Justice Stevens and Justice Ginsburg, who was diagnosed with pancreatic cancer in February 2009, are widely believed to be the next justices who will retire from the Court. The retirement of either Justice Stevens or Justice Ginsburg will give President

Obama the opportunity to name another nominee but will probably not change the ideological balance of the Court. For that to happen, one of the conservatives would have to step down during President Obama's term in office. None of the current conservative justices has even hinted at retirement.

For the same reason, the recently-appointed Justice Sotomayor is not expected to shift the ideological balance of power on the Court, as she is considered a liberal jurist and is taking the seat of another reliably-liberal vote in Justice Souter.⁴ Justice Sotomayor's most high-profile and controversial ruling prior to her Supreme Court appointment was the affirmative action case of Ricci v DeStefano, in which she sided with the City of New Haven, Connecticut, when it withheld promotions for white fire fighters when no black firefighters scored high enough on the promotion exam to be considered for elevation of rank within the fire department. Her ruling in Ricci, as well as several other public statements made by Justice Sotomayor over the years, have led some conservative Republicans to label Justice Sotomayor a "judicial activist."⁵ For instance, during a 2005 speaking engagement at Duke University, Justice Sotomayor said that "a court of appeals is where policy is made."⁶ However, during her Senate confirmation hearings for her appointment to the Supreme Court, Justice Sotomayor stated that she did not want to be viewed as a judicial activist and, in her opening statement, declared her judicial philosophy to be "fidelity to the law." She added that "[t]he task of a judge is not to make law. It is to apply the law."⁷

Despite the fact that Justice Sotomayor is considered to be liberal, Presidential appointees to the Supreme Court have often surprised Presidents and legal observers with their decisions once taking their seats on the high court. Justice Souter, for example, was

considered a conservative when he was appointed to the Supreme Court by President George H.W. Bush in 1990, but became a generally reliable pillar of the liberal wing of the Court in the nineteen years after his appointment.⁸ This is evidenced by the fact that Justice Souter chose to retire so soon after Republican President George W. Bush left office, when a successor could be nominated by President Obama.⁹ Justice Stevens and Justice Ginsburg are also widely believed to have hung on despite Stevens' age and Ginsburg's health problems until they could be sure a liberal President would appoint successors who would follow in their ideological footsteps.¹⁰

The Supreme Court began its new term on 5 October 2009, with a "business-heavy" docket.¹¹ More than half of the forty-five cases set to be decided in the new term focus on business, a number that is greater than in past terms.¹² Thus far, no employment law cases and no environmental disputes have been granted review by the Court and, for the first time in several terms, no cases involving the issue of federal law "preemption" of state common law tort claims are set to be heard.¹³ The Court will, however, hear significant cases on patents, separation of powers, antitrust law and white-collar crime.¹⁴

In addition to shaping the future composition of the United States Supreme Court, President Obama will be able to shape all other federal courts given that thirteen federal courts of appeals and ninety-three federal district courts had, at the start of his term, fifty-four judicial vacancies that the President and Democratic Senate could, if they choose, largely fill in 2009-2010.¹⁵

Accordingly, President Obama's impact on the Courts may continue to be felt long after he leaves office and even if he serves only a single term in office.

III. DEVELOPMENTS EFFECTING PRODUCT LIABILITY, TORT AND ENVIRONMENTAL CLAIMS IN THE UNITED STATES

The more consumer-friendly, less “pro-business” tone coming out of Washington with the change in administrations, the election of Democratic majorities in both the Senate (58-40-2)¹⁶ and House of Representatives (256-177), and the worldwide economic crisis, likely means that the U.S will see an increase in product liability, consumer, environmental and tort claims across broad sectors of industry, including the pharmaceutical industry that has long been a favorite target of the plaintiffs’ bar. In fact, with President Obama’s appointment of Dr. Margaret Hamburg as the new Commissioner of the Food and Drug Administration (“FDA”), and his appointment of Lisa Jackson as the new head of the Environmental Protection Agency (“EPA”), the page has apparently been turned on what many critics considered to be an era in FDA and EPA history in which the agencies favored the interests of big business over the interests of consumers and the environment.

Under the Bush administration, the FDA reversed its long-standing position that FDA approval of a drug did not “preempt” state tort failure to warn claims and that federal labeling requirements set minimum standards that could be supplemented by the states.¹⁷ In its 2006 about-face, the FDA turned its back on decades of agency policy when it declared that “State law actions . . . threaten[ed] [its] statutorily prescribed role as the expert Federal agency responsible for evaluating and regulating drugs.”¹⁸ This pronouncement was viewed by many as a slap in the face to consumers and an example of the Bush administration’s pro-business mindset. Dr. Hamburg’s predecessor in the FDA commissioner’s job, Dr. Andrew C. von Eschenbach, often had to deflect critics who

accused the Bush administration of letting politics play too forceful a role in science policy.¹⁹

The issue of federal law preemption of state common law tort claims was largely put to rest by the Supreme Court in 2009 in the case of Wyeth v. Levine. By a six to three margin, the Supreme Court ruled against preemption of state common law tort actions involving FDA-approved drugs and stated that “Congress did not intend FDA oversight to be the exclusive means of ensuring drug safety and effectiveness.” According to the Court, it is possible for a pharmaceutical company to comply with both its federal law obligations and its state law obligations, by adding a stronger warning to the drug label.

The Wyeth decision was hailed as a milestone victory by consumer advocacy groups and, of course, by the plaintiffs’ bar, and rendered moot an effort by Democratic legislators to pass a bill that would have prevented the preemption of state common law tort claims involving FDA-approved drugs in the event the Supreme Court had ruled in favor of preemption in Wyeth. However, Democratic efforts to undo federal preemption of state common law tort claims in other areas continue. For example, unlike FDA-approved drugs, federally-approved medical devices marketed for sale in the U.S. are subject to the express preemption provisions of the Medical Device Amendments of 1976 (“MDA”). On 5 March 2009, Democratic sponsors in the House of Representatives introduced a bill entitled the Medical Device Safety Act of 2009, which would amend the MDA by effectively eliminating the express preemption provision. The proposed bill is still being debated in committee and has not been taken up for a vote. If Congress passes the Medical Device Safety Act of 2009, or a similar bill eliminating preemption of state common law tort claims involving FDA approved medical devices, the likely result will

be an increase in the number of claims filed against medical device manufacturers previously protected under the auspices of the MDA.

In addition to the developments relating to preemption of state product liability claims, a more proactive FDA has materialized under the Obama administration. On 6 August 2009, FDA Commissioner Hamburg delivered a speech to the Food and Drug Law Institute in which she stated that the FDA is enacting a strategy to “support private sector compliance” by pursuing enforcement actions against companies that violate federal food and drug safety laws.²⁰ Dr. Hamburg acknowledged that in recent years the FDA’s enforcement efforts did not always live up to its obligations and that many of the enforcement actions that the FDA did undertake had been hampered by unreasonable delays.²¹ In fact, between 2004 and 2008 the number of “warning letters” issued by the FDA declined by nearly forty percent, from 725 to 445.²² In her speech, Dr. Hamburg outlined five procedural changes that she believes will help ensure that violations of federal food and drug safety laws are taken seriously, including reaching out to local, state and international officials who have more authority than the FDA to quickly take action when public health is at risk.²³

On 2 September 2009, for example, the FDA announced a \$2.3 billion settlement with pharmaceutical giant Pfizer Inc. over the company’s illegal promotion of its now-withdrawn painkiller, Bextra.²⁴ Pfizer took Bextra off the market in 2005 after U.S. and European regulators said that the drug’s risks of heart attacks and strokes outweighed its benefits. The FDA alleged that Pfizer had illegally marketed Bextra for “off-label” uses, that is, as a treatment for medical conditions different than those the drug had been approved for by the FDA.²⁵ The \$2.3 billion settlement with the FDA is the largest ever

paid by a drug company for alleged violations of federal drug rules.²⁶ Under the Obama administration and the leadership of Dr. Hamburg, more enforcement actions can be expected.²⁷

With the change in administrations, heavy industry in the U.S. may also see an increase in claims as a result of more stringent environmental laws and regulations and increased enforcement of regulations under the EPA's new leadership. In sharp contrast to his predecessor in the Oval Office, President Obama is a strong proponent of environmental protection measures, including a "cap and trade" approach to reducing carbon emissions. The House of Representatives has already passed the American Clean Energy and Security Act of 2009 which, among other things, imposes limits on industrial carbon emissions and establishes the trading of carbon credits. Debate over the bill has now moved on to the Senate.

In this political climate, the courts are also stepping into the fray when it comes to the debate over the environment and "green" measures. On 21 September 2009, the United States Court of Appeals for the Second Circuit decided Connecticut v. American Electric Power, holding that state governments and private organizations may pursue nuisance claims based on federal common law against companies that emit carbon dioxide from their facilities.²⁸ In American Electric, eight states, New York City and three environmental land trusts alleged that carbon dioxide from power plants contribute to global warming and sought to use federal nuisance claims to require that the defendants cap and then reduce their carbon emissions over time. The Second Circuit's decision in American Electric may mark the beginning of a surge of climate-related litigation against a broad array of companies both within and outside of the electric utility industry

specifically targeted in the case. Some insurance experts have dubbed climate-related litigation as potentially being the “new asbestos.”²⁹

In short, the U.S. is not likely to see a decrease in products liability, environmental or mass tort litigation in the coming years. Some business sectors, such as pharmaceutical and medical device manufacturers, may likely see even more claims as a result of Congressional mandates and a more consumer-friendly FDA prepared to pursue enforcement actions against companies that violate federal law. This, in turn, may embolden plaintiffs’ attorneys in their own pursuit of claims against the pharmaceutical and other industries. New areas of litigation are also opening up, including climate-related litigation that may prove to have a significant impact on utilities and heavy industry. The end-result may be an increase in claims made under liability policies issued to pharmaceutical manufacturers, medical device manufacturers, industrial manufacturers and others.

IV. PRESIDENT OBAMA AND TORT REFORM

During the course of his presidency, President George W. Bush was a strong proponent of tort reform measures in the U.S., particularly caps on punitive damages and non-economic damages for pain and suffering. With the election of President Obama and the Democratic majorities in the House and Senate, any chance of large-scale tort reform appeared to have died. However, recent comments by President Obama suggest that while tort reform may be on life support, it is not altogether dead.

President Obama’s efforts in his first months in office have largely been focused on healthcare reform, one of the centerpieces of his agenda. To the President’s consternation, getting a healthcare bill passed has proven to be more difficult than

anticipated, even with his party holding a majority in both houses of Congress. Recently, in his efforts to get a healthcare reform bill passed, President Obama extended an “olive branch” to Congressional Republicans by agreeing to consider medical malpractice reform. On 9 September 2009, during a speech to a joint session of Congress addressing his proposals for healthcare reform, the President stated:

Now, finally, many in this chamber – particularly on the Republican side of the aisle – have long insisted that reforming our medical malpractice laws can help bring down the cost of healthcare . . . Now, I don’t believe malpractice reform is a silver bullet, but I’ve talked to enough doctors to know that defensive medicine may be contributing to unnecessary costs. So I am proposing that we move forward on a range of ideas about how to put patient safety first and let doctors focus on practicing medicine. I know that the Bush administration considered authorizing demonstration projects in individual states to test these ideas. I think it’s a good idea, and I’m directing my Secretary of Health and Human Services to move forward on this initiative today.³⁰

The President’s comments yielded a lukewarm response from both tort reform advocates and opponents.³¹ While tort reformers praised the President for mentioning the issue of tort reform in his speech, they say that he did not go nearly far enough.³² On the other hand, tort reform opponents, including trial lawyer groups, said that any reforms should concentrate on reducing medical errors and not on capping damages or otherwise imposing limits on tort claims.³³

In a major television interview given several days after his speech to the Joint Session of Congress, President Obama expressly dismissed the notion that his version of tort reform would include such measures as caps on non-economic damages such as pain and suffering or punitive damages.³⁴ He stated that “what I would be willing to do is consider any ideas out there that would actually work in terms of reducing costs,

improving the quality of patient care. So far the evidence I've seen is that caps will not do that.”³⁵ The President also stated that “I think there has also been philosophical issues and differences [between Democrats and Republicans] about whether or not patients who really have been subject to negligence, whether its fair to just say to them, ‘You know what, you can only get a certain amount no matter how egregious it is.’ So there has been a philosophical difference within the parties.”

This “philosophical difference” between the Democrats and Republicans is demonstrated by Republican-sponsored legislation introduced earlier this year that would strictly limit punitive damages in medical malpractice cases.³⁶ Under the proposed bill, punitive damages would only be awarded if it could be proven that a person acted with malicious intent or deliberately failed to avoid unnecessary injury.³⁷ Further, punitive damages would be capped at \$250,000 and the bill would establish a statute of limitations of three years after the date of manifestation of injury or one year after the claimant discovers the injury, with certain exceptions.³⁸ This is similar to legislation previously endorsed by President Bush during his time in office that would have imposed a \$250,000 cap on non-economic damages.

Rather than including any types of damages caps, the “demonstration projects” referred to by President Obama in his recent joint session speech would involve state-level experiments aimed at improving patient safety and implementing early-resolution programs between doctors and patients. White House officials have said that the state-level experiments could include a method, already being used in roughly half of the states, in which patients who want to sue must first get a certificate from a panel of medical experts that their case appears to have some merit.³⁹ Other experiments, the White House

said, could involve an idea, proposed by then-Senator Obama in unsuccessful legislation co-sponsored with then-Senator Hillary Clinton in 2005, that is being tried at a few hospitals: a program in which doctors disclose mistakes early, apologize and try to negotiate a payment to the patient.⁴⁰ Accordingly, even with the President indicating that he is open to some form of tort reform, there is still an apparently great divide between Democrats and Republicans on the issue.

While any version of tort reform that includes measures such as non-economic damages caps is unlikely, given the President's current stance and the present composition of Congress, it certainly cannot be ruled out as a bargaining chip in the ongoing heated debate on healthcare reform. It is possible that in order to save healthcare reform, the Democrats would be willing to make concessions on tort reform. It must also be noted that, as a Senator, President Obama voted in favor of the Class Action Fairness Act, which was signed by President George W. Bush in 2005 and limits victims' rights in possible class-action lawsuits and requires many types of cases to be heard only in federal court.⁴¹ Furthermore, when he was member of the Illinois state legislature, President Obama voted in favor of caps on non-economic damages in medical malpractice cases.⁴² Both of these actions, particularly the latter, are inconsistent with the President's current stance, and, perhaps, indicate that his position on tort reform is malleable and that tort reform in the U.S. may not be dead after all.

V. THE CURRENT POSTURE OF REGULATORY REFORM IN THE UNITED STATES

A. Increased Federal Regulation of Banking and Financial Sectors

Over the past two years we have faced the most severe financial crisis since the Great Depression. Americans across the nation are struggling with unemployment, failing businesses, falling home prices, and declining savings. These challenges have forced the government to take extraordinary measures to revive our financial system so that people can access loans to buy a car or home, pay for a child's education, or finance a business.

* * *

We must act now to restore confidence in the integrity of our financial system. The lasting economic damage to ordinary families and businesses is a constant reminder of the urgent need to act to reform our financial regulatory system and put our economy on track to a sustainable recovery. We must build a new foundation for financial regulation and supervision that is simpler and more effectively enforced, that protects consumers and investors, that rewards innovation and that is able to adapt and evolve with changes in the financial market.⁴³

So begins the introduction to the Department of the Treasury's "white paper" entitled Financial Regulatory Reform, A New Foundation: Rebuilding Financial Supervision and Regulation (the "financial regulatory reform white paper"). Released in June 2009, the financial regulatory reform white paper sets forth reforms proposed by the Obama administration to meet what are described in the paper as "five key objectives" to:

- (1) Promote "robust" supervision and regulation of financial firms;
- (2) Establish "comprehensive" supervision of financial markets;
- (3) Protect consumers and investors from financial abuse;
- (4) Provide the federal government with the tools it needs to manage financial

crises; and

(5) Raise international regulatory standards and improve international cooperation.⁴⁴

Significantly, the proposed reforms would include the establishment of at least four new federal boards or agencies with specific oversight, regulatory and enforcement powers. We shall highlight herein some of the proposals that may have an impact upon insurers either directly, or through the institutions that they insure, and which are emblematic of the “change” which President Obama is attempting to implement in the U.S. in the wake of the financial crisis.

The Obama administration has proposed, for instance, that a Financial Services Oversight Council (“FSOC”) be created to facilitate information-sharing and coordination between government regulatory agencies; identify emerging risks; advise the Federal Reserve Board about firms whose failure could pose a threat to financial stability; and provide a forum for resolving jurisdictional disputes between regulators.⁴⁵ Membership on the FSOC would include, among others, the Secretary of the Treasury, the Chairman of the Board of Governors of the Federal Reserve System, and the Chairman of the SEC.⁴⁶ The proposed legislation would give the FSOC the authority to gather information from any financial firm and to refer emerging risks to the attention of regulators with the authority to respond.⁴⁷

The financial regulatory reform white paper also outlines the administration’s proposal for the creation of a new federal government agency, the National Bank Supervisor (“NBS”), which would supervise and regulate all federally-chartered depository institutions and all federal branches and agencies of foreign banks.⁴⁸ The NBS would act as the sole federal agency dedicated to these tasks, and would take over the

responsibilities of the Office of the Comptroller of the Currency, which currently charters and supervises nationally-chartered banks and federal branches and agencies of foreign banks, and the Office of Thrift Supervision, which currently supervises federally-chartered thrifts and thrift holding companies.⁴⁹ Under the proposal, the Federal Reserve Board and the Federal Deposit Insurance Corporation (“FDIC”) would maintain their respective roles in the supervision and regulation of state-chartered banks.⁵⁰

The proposed “robust” supervision and regulation of financial firms would also include a requirement that hedge funds and other private equity or venture capital funds register with the SEC.⁵¹ Until now, U.S. law has generally not required such funds to register with a federal financial regulator.⁵² Under the proposal set forth in the financial regulatory reform white paper, the SEC would conduct regular, periodic examinations of hedge funds to monitor compliance with record-keeping requirements, requirements with respect to disclosures to investors and creditors, and regulatory reporting requirements.⁵³

As part of the Obama administration’s stated objective of protecting consumers and investors from financial abuse, it has also proposed the creation of a new Consumer Financial Protection Agency (“CFPA”), which would be the single federal agency dedicated to protecting consumers in the financial products and services markets, except for those investment products and services already regulated by the SEC.⁵⁴ Under the proposal, the CFPA would have supervisory and enforcement authority and jurisdiction over insured depositories and other institutions, such as mortgage companies not owned by banks, that traditionally fell into a regulatory “no mans land.”⁵⁵ It would also have sole authority to promulgate and interpret regulations under existing consumer financial services and fair lending statutes, many of which contain private rights of action.⁵⁶ The

Obama administration does not propose to disturb these statutes but “[i]n some cases . . . may seek legislation to increase statutory damages” to which consumers would be entitled.⁵⁷ Further, any rules promulgated by the CFPA would serve as a “floor” and not a “ceiling.”⁵⁸ That is, the states would have the ability to adopt and enforce stricter consumer protection laws if they so chose.⁵⁹

The Obama administration also proposes to strengthen investor protections by giving the SEC expanded authority to promote transparency in investor disclosures.⁶⁰ It seeks to impose a fiduciary duty on broker-dealers who offer investment advice.⁶¹ The financial regulatory reform white paper notes that in the wake of the scandals associated with the current financial crisis, particularly the Ponzi scheme orchestrated by Bernard Madoff, the SEC has already begun to strengthen and streamline its enforcement process and to expand resources for enforcement in the fiscal year 2010 budget.⁶² The SEC has also streamlined the process of obtaining formal orders that grant its staff subpoena power and has begun a review of its technology and processes to assess risk and manage leads for potential fraud and abuse.⁶³

B. Increased Federal Monitoring and Regulation of Insurance Sector

Significantly, under the Obama administration’s proposed plan for increased supervision and regulation of financial institutions, the insurance sector -- traditionally regulated by the states -- would also see enhanced government oversight through the establishment of an Office of National Insurance (“ONI”).⁶⁴ The proposed ONI would be established within the Treasury Department and would “be responsible for monitoring all aspects of the insurance industry,” including gathering information regarding, and being responsible for identifying, the emergence of any problems or gaps in regulation that

could contribute to a future financial crisis.⁶⁵ The ONI would also recommend to the Federal Reserve any insurance companies that it believes should be supervised as Tier I “financial holding companies,” that is, institutions whose failure could pose a threat to financial stability due to their size and leverage.⁶⁶ The proposal stems in part from the failure of insurance giant American International Group (“AIG”) and recognizes that while AIG’s main problems were created outside of its traditional insurance business, significant losses also arose inside its state-regulated insurance companies.⁶⁷

According to the financial regulatory reform white paper, over 135 years of state regulation of the insurance industry has “led to a lack of uniformity and reduced competition across state and international boundaries, resulting in inefficiency, reduced product innovation, and higher costs to consumers.”⁶⁸ The Obama administration therefore believes that there must be a standing federal entity accountable for understanding and monitoring the insurance industry beyond the few specific areas, such as employee benefits, terrorism risk insurance and flood insurance, where the federal government presently has any statutory responsibility.⁶⁹ Further, recognizing that the U.S. is the only country in the International Association of Insurance Supervisors that is not represented by a central insurance regulatory entity able to speak with one voice, the administration believes that a federal insurance entity is necessary.⁷⁰ It also deems a single federal insurance entity as necessary in light of recent European Union legislation requiring foreign insurance companies operating in any of its member states to be subject to supervision in the company’s home country comparable to the supervision required in the EU.⁷¹

The financial regulatory reform white paper refers to six principles for insurance regulation:

- (1) Effective systemic risk regulation with respect to insurance;
- (2) Strong capital standards and an appropriate match between capital allocation and liabilities for all insurance companies;
- (3) Meaningful and consistent consumer protection for insurance products and practices;
- (4) Increased national uniformity through either a federal charter or effective action by states;
- (5) Improved and broadened regulation of insurance companies and their affiliates on a consolidated basis, including those affiliates outside of the traditional insurance business (e.g., AIG); and
- (6) International coordination, including improving insurance regulation in the U.S. in order to satisfy existing international frameworks.⁷²

On 1 October 2009, Congressman Paul E. Kanjorski (D-PA), Chairman of the House Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, released discussion drafts of three pieces of legislation aimed at tackling key proposals set forth in the regulatory reform white paper, including the proposals for insurance reform. The draft bills include what have been dubbed the Investor Protection Act, the Private Fund Investment Advisors Act and the Federal Insurance Office Act. The latter bill mirrors much of what the Obama administration is calling for in the regulatory reform white paper: a federal office that would collect and analyze data on insurance; monitor and identify gaps in the regulation of insurance;

establish federal policy on insurance matters; and ensure that state insurance laws remain consistent with federal policy in coordinating international trade agreements.⁷³

Reaction to these proposals has generally met with a favorable reception by insurance trade groups. The Risk and Insurance Management Society Inc., for example, announced that it supports the Obama administration's efforts to establish the ONI and believes that "this important legislation represents a much-needed step forward in the process of financial services modernization."⁷⁴ The insurance trade journal Business Insurance also announced its support for a federal insurance office, believing that it would provide federal authorities with in-house expertise on insurance matters, guarantee the insurance industry a place at the federal regulatory table that other financial institutions already enjoy, and facilitate international cooperation on insurance issues.⁷⁵ However, some "Main Street" home, auto and business insurers have announced their opposition to what they have described as "consumer-costly regulations."⁷⁶ Groups such as the Property Casualty Insurers Association of America are urging the Obama administration and Congress to target reforms where the problems in the financial sector occurred, i.e., Wall Street, where the AIG's of the world reside, and not Main Street, with its "small businesses and activities that are not highly leveraged or systemically risky."⁷⁷

It is as yet unclear at this early stage whether a federal insurance office will have any real regulatory powers or be more of a monitoring and information gathering entity only. If it is regulation that is truly being sought by the administration and proponents of a federal insurance office, a question that will almost certainly be the subject of Congressional debate is whether the proposed insurance regulatory reforms conflict with the McCarran-Ferguson Act (the "Act"), 15 U.S.C. § 1011, the federal law passed in 1945

that allows the states to regulate the business of insurance without federal government interference and generally provides that federal antitrust laws will not apply to the business of insurance.

Other insurance-related federal legislation may also be on the horizon. In light of the fact that more than twenty-five percent of commercial insurance in the U.S. is placed in the nonadmitted, or surplus lines, market, some insurance industry lobbying groups believe that a uniform approach, under which the rules of the insureds' home state apply in the case of multi-state placements, is an improvement over the existing complicated "quilt" of state regulations.

On 9 September 2009, the House of Representatives passed H.R. 2571, the Nonadmitted and Reinsurance Reform Act of 2009 ("NRRA").⁷⁸ The Council of Insurance Agents and Brokers praised the bill as "a major step towards modernizing the insurance regulatory system by providing a uniform approach to regulating the commercial surplus lines market."⁷⁹ The NRRA was co-sponsored by a Republican and a Democrat. Among other things, it provides that the placement of nonadmitted insurance shall be subject to the statutory and regulatory requirements solely of the insured's home state. It further provides that any law or regulation of any state that applies to nonadmitted insurance sold to an insured whose home state is another state shall be preempted by the home state's regulations. The draft Federal Insurance Office Act similarly includes a provision that any state insurance measures that directly or indirectly treat a foreign insurer more favorably than a domestic insurer shall be preempted.

The NRRA further provides for the regulation of credit for reinsurance and reinsurance agreements. It states that if the state of domicile of a ceding insurer is

accredited by the National Association of Insurance Commissioners (“NAIC”), or has financial solvency requirements substantially similar to the requirements necessary for NAIC accreditation, and recognizes credit for reinsurance for the insurer’s ceded risk, then no other state may deny such credit for reinsurance. In addition, the bill would preempt extraterritorial application of state law. That is, all laws, regulations, provisions or other actions of a state that is not the domiciliary state of the ceding insurer, except those with respect to taxes and assessments on insurance companies or insurance income, would be preempted to the extent that they: (1) restrict or eliminate the rights of the ceding insurer or the assuming insurer to resolve disputes pursuant to contractual arbitration; (2) require that a certain state’s law shall govern the reinsurance contract, disputes arising from the reinsurance contract or requirements of the reinsurance contract; (3) attempt to enforce a reinsurance contract on terms different than those set forth in the reinsurance contract; or (4) otherwise apply the laws of the state to reinsurance agreements of ceding insurers not domiciled in that state.

With respect to regulation of reinsurers, the NRRA provides that if the state of domicile of a reinsurer is an NAIC-accredited state, or has financial solvency requirements substantially similar to the requirements necessary for NAIC accreditation, then such state shall be solely responsible for regulating the financial solvency of the reinsurer. The NRRA has not been voted on by the Senate.

Recently, on 23 September 2009, the NAIC’s Government Relations Leadership Council approved, for submission to Congress, the Reinsurance Regulatory Modernization Act of 2009 (“RRMA”), a proposed federal bill that would modernize the regulation of reinsurance by the states.⁸⁰ The legislation would create two new classes of reinsurers in

the U.S.: National Reinsurers (U.S.) and Port of Entry Reinsurers (non-U.S.). In order to transact reinsurance business in the U.S., National Reinsurers would be licensed through a single Home State while Port of Entry Reinsurers would be certified through a single Port of Entry State. Reinsurers would continue to have the option of operating under the existing regulatory approach. The legislation would also provide for the establishment of a Reinsurance Supervision Review Board as a federal entity responsible for evaluating states and non-U.S. jurisdictions. State insurance supervisors would be responsible for evaluating their respective National and Port of Entry Reinsurers and establishing appropriate collateral requirements for reinsurance agreements. State laws with credit for reinsurance requirements different from the federal legislation would be preempted as to National and Port of Entry Reinsurers.

According to the NAIC President, “the NAIC has endorsed the proposed federal legislation to facilitate cross-border reinsurance transactions and enhance competition within the U.S. market, while ensuring that the U.S. policyholders are adequately protected against the risk of insolvency.”⁸¹ The Acting Chair of the NAIC’s Reinsurance Task Force added that “we are supporting this federal legislation in order to preserve and improve state-based regulation of reinsurance, ensure timely and uniform implementation of this legislation throughout all states, and as a more comprehensive alternative to the reinsurance provisions of the recently passed Non-admitted and Reinsurance Reform Act.”⁸²

At this time, with the President and Congress focused on the issue of healthcare reform, these proposals remain in their infancy. Congressional committees are in the process of debating the Obama administration’s financial services regulatory reform plan,

including its proposals for insurance regulatory modernization.⁸³ Nevertheless, if reform measures pass, as they likely will, in one form or another, with a Democratic majority in both houses of Congress, the effects will almost certainly be felt by the insurance industry. With the emphasis on reform of the banking and financial sectors, an increase in civil enforcement actions will likely lead to an increase in claims asserted under D&O policies. Increased claims may also arise as a result of stronger consumer protection measures. Finally, the establishment of an ONI and other measures pertaining to federal insurance oversight may also ultimately lead to greater federal regulation of the insurance industry in the U.S. and have a direct impact on the insurers. If enacted by Congress, these measures, and perhaps others, will have a direct impact on the insurance industry and insurance regulation in the U.S.

VI. CONCLUSION

“Reform” in the shape of increased government regulation of the banking, financial and, even, insurance sectors will likely occur in the U.S. in the course of the next year. Laws protecting consumers and according greater enforcement powers to existing federal agencies, such as the SEC, and to proposed new agencies, such as the Office of National Insurance, are also on the horizon.

With a Democratic controlled Congress in power until at least the end of 2010, when mid-term elections will be held, some versions of proposed reform bills will likely become law. What remains to be seen is the size and scope of these reforms. As President Obama has learned when it comes to healthcare reform, the fact that one party has a majority in both house of Congress, including a filibuster-proof majority in the

Senate, is no guarantee that there will be a consensus when it comes to proposed reforms such that legislation will be quickly sheparded through Congress.

If the reforms discussed herein become law, their effects will be felt by the insurance industry in the form of increased claims by insureds such as banks, financial institutions and pharmaceutical companies that become the subject of a greater number of enforcement actions by government agencies and private causes of action by shareholders and consumers. Reforms aimed at establishing greater federal oversight of the insurance industry will also have a direct impact on insurers, whose industry, until now, has primarily been regulated by the states.

Nothing is certain in politics, however. For instance, President Obama has already extended an olive branch to the Republicans on tort reform in an effort to gain concessions on healthcare reform. Although the President is on record as saying that he is against caps on tort damages awards, it is always possible that he will drop this stance if that results in a “victory” such as passage of a healthcare reform bill. Tort reform may not, after all, be dead in the U.S. Further, although President Obama has already made a mark on the Supreme Court with the appointment of liberal jurist Sonia Sotomayor to the bench, history has proven time and again that Presidential nominees to the high court, including the recently-retired “conservative-to-liberal” Justice David Souter, are not always what they seem.

It is a time of “change” in the U.S. Just how far that change goes is still an open question.

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⁵ Id.
⁶ Id.
⁷ Sotomayor Hearing: Why Shouldn't Judges Make Policy, Time Magazine, July 16, 2009.
⁸ Obama May Pick Sotomayor for Supreme Court, www.upi.com.
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¹¹ Corporate Disputes Dominate the Docket as a New Justice Joins the Court, www.law.com, September 28, 2009.
¹² Id.
¹³ Id.
¹⁴ Id.
¹⁵ The Courts Under President Obama, 86 Denv. U.L. Rev. 727 (2009).
¹⁶ The two independent members of the Senate caucus with the Democrats.
¹⁷ 63 Fed. Reg. 66378, 66384 (1998).
¹⁸ 71 Fed. Reg. 3922, 3935 (2006).
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²³ Effective Enforcement and Benefits to Public Health, www.fda.gov/newsevents/speeches/ucm175983.htm.
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²⁵ Pfizer to Pay Record \$2.3B Penalty, Associated Press, September 2, 2009.
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³³ Id.
³⁴ Obama Clarifies Position on Tort Reform on "60 Minutes," www.cbsnews.com, September 14, 2009.
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³⁶ Id.
³⁷ H.R. 1086: Help Efficient, Accessible, Low-Cost, Timely Healthcare (HEALTH) Act of 2009.
³⁸ Id.
³⁹ On Malpractice Reform, Fine Print is Still Hazy, Washington Post, September 11, 2009.
⁴⁰ Id.
⁴¹ The Candidates and Tort Reform, Chicago Lawyer, February 1, 2008.
⁴² Id.
⁴³ Financial Regulatory Reform: A New Foundation, Department of the Treasury (2009), at 2.
⁴⁴ Id. at 2-3.
⁴⁵ Id. at 10.

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47 Id.
48 Id. at 12.
49 Id. at 32.
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51 Id. at 12.
52 Id. at 37.
53 Id.
54 Id. at 14.
55 Id. at 14, 56.
56 Id. at 58.
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58 Id. at 61.
59 Id. at 60.
60 Id. at 15.
61 Id. at 71.
62 Id. at 70.
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