



INSURANCE AND FINANCIAL SERVICES UPDATE

2011 YEAR IN REVIEW

Last year, Sidley Austin LLP's Insurance & Financial Services Group issued a client alert listing Ten Items to Watch in 2011. With that year concluded, we take this opportunity to review the items and report briefly on their development in 2011.

- 1. Monitor the full roll-out of Dodd-Frank.** Developments will include the newly-created Federal Insurance Office's (FIO) report on insurance regulation under Title V, and rulemaking with respect to swaps under Title VII.

UPDATE:

2011 saw the continued roll-out of Dodd-Frank. Most directly for the insurance industry, the Nonadmitted and Reinsurance Reform Act of 2010 (§§ 511-542 of Dodd-Frank) became effective July 21, 2011. In addition, the U.S. Treasury Department announced in November 2011 that 15 individuals had been appointed to the Federal Advisory Committee on Insurance, with the Committee providing advice to the FIO, whose report on insurance regulation is imminent. For more information, [click here](#).

- 2. Understand the moving parts of reinsurance collateral reform involving non-U.S. reinsurers.** The NAIC has weighed in, Dodd-Frank has made clear that only the cedent's home state decides the credit for reinsurance issue, individual states have begun to amend credit for reinsurance provisions, and the FIO arguably has tools at its disposal to negotiate treaties and preempt state laws on the issue.

UPDATE:

The reinsurance collateral reform involving unlicensed, non-U.S. reinsurers was adopted in November 2011 by the NAIC as amendments to its Credit for Reinsurance Model Act and Regulation. The individual states will now need to amend their credit for reinsurance laws. At least four states have implemented the collateral reform independently from the NAIC Model Act amendments, and three other states have legislation pending to do the same. For more information, [click here](#).

- 3. Keep abreast of the NAIC's solvency modernization initiative.** Expansion of insurance holding company requirements and scrutiny of "enterprise risk" were added to the Model Insurance Holding Company System Regulatory Act and Regulation. The NAIC is also considering changes to risk-based capital calculations.

UPDATE:

The NAIC's Solvency Modernization Initiative (SMI) continued to move forward with the adoption of the Own Risk Solvency Assessment Guidance Manual and the release of a memorandum describing existing corporate governance requirements for U.S. insurance companies, at the NAIC's November 2011 meeting. Other aspects of SMI will continue to progress in 2012, including investigation of alternative accounting standards to those contained in existing Statutory Accounting Principles (SAP).

4. Prepare a Solvency II plan. The revised set of EU-wide capital requirements and risk management standards do not come into force until January 2013, but any company with European operations and European insurers with operations outside the EU will need to plan for the consequences. The changes may well create M&A opportunities for investors.

UPDATE:

With further slippage in the Solvency II timetable during 2011, insurers are not now expected to be subject to its new capital and risk management requirements until January 2014. The market has not yet seen the widely predicted wave of M&A ahead of implementation. This may well still occur once there is greater certainty in relation to the new capital requirements, implementation timescales and transitional measures. In the interim, many of the larger insurance groups are in the process of undertaking internal reorganizations to optimize capital structures ahead of Solvency II implementation. This has resulted in insurance business transfers under Part VII of the UK's Financial Services & Markets Act 2000 running at an all time high and an increase in cross border transfers of insurance business within Europe.

5. Learn to navigate the new insurance commercial bribery pot holes. Incorporate Dodd-Frank, the U.S. Foreign Corrupt Practices Act (FCPA), the UK Bribery Act, local Administrations for Industry and Commerce in China, and Southeast Asia initiatives into training and compliance programs.

UPDATE:

In July 2011, the UK Financial Services Authority announced a fine of £6.895 million levied on an insurance broker for failure to have in place adequate procedures to monitor payments and conduct adequate due diligence of third-parties during the period January 2005 through December 2009. Heightened investigations of fraud and corruption (and resulting fines) under the FCPA, as well as increased activities by non-US jurisdictions, confirm the need for a well-designed compliance program. For more information on the FCPA, [click here](#) and for more information on the UK Bribery Act, [click here](#).

6. Ensure compliance with the EU's data protection regime and with other international data privacy laws. The use of personal data on employees and policyholders is highly regulated in the EU, with requirements to register with Data Protection Authorities, data security obligations and restrictions on transfer of personal data from the EU. There have also been a number of recent enforcement actions by EU authorities against insurance companies for failing to comply with data protection requirements, which have resulted in significant fines and reputational damage.

UPDATE:

A proposed EU Data Protection Regulation was announced by the European Commission in Brussels on January 25, 2012. As proposed, the Regulation will have a significant impact on almost every business in the EU and non-EU businesses that have EU customers. The proposed Regulation introduces fines of up to 2% of annual worldwide turnover. It will also require many businesses to appoint data protection officers and undertake detailed privacy impact assessments among many other obligations. The proposed Regulation also introduces new rights for individuals, including a right to have their personal data deleted and for the data to be transferred to a new service provider. Consumer organizations can also make complaints to supervisory authorities and bring class actions on behalf of individuals for non-compliance with the proposed Regulation. In addition, US federal and state regulators are increasing their focus on data protection and privacy issues within the insurance sector. For more information, [click here](#).

- 7. Evaluate investments and portfolio holdings, particularly with respect to asset- and mortgage-backed securities.** Insurer litigation against major banks and investment banks has begun to make headlines, and the entire U.S. mortgage finance industry is subject to reform and reconstruction.

UPDATE:

This litigation continues to make headlines in the U.S., with cases by investors against investment banks, cases by financial guaranty insurers against banks who originated such securities, and other permutations. In light of the 2011 difficulties in the Eurozone and the significant holdings of sovereign debt by European insurance companies, increased regulatory scrutiny is likely in 2012. For more information, [click here](#).

- 8. Audit business practices to minimize the chances of being sued in the current spate of class actions in the U.S.** Retained asset account, revenue sharing, and annuity practices have been targeted.

UPDATE:

Retained asset account class actions continue to be filed, with some dismissed and others surviving motions to dismiss. In one such case, the federal court in Massachusetts certified a class of beneficiaries of life policies. The certification has been appealed to the U.S. Court of Appeals for the First Circuit, where it is now being briefed and should be decided in 2012. In a similar manner, state escheat officials have been investigating life insurance companies' alleged failure to use the Social Security Administration's Death Master File to determine if policyholders may have died (resulting in the claim that death benefits were not paid to beneficiaries). Follow on class action litigation can be expected. For more information, [click here](#).

- 9. Urge the fullest possible disclosures by arbitrators, for the sake of finality of the eventual award.**

The Second Circuit should rule this year in the appeal in *Scandinavian Reinsurance Co. v. St. Paul Fire & Marine Ins. Co.*, 732 F. Supp. 2d 293 (S.D.N.Y. 2010), which vacated an arbitration award on the basis of "evident partiality" after finding inadequate arbitrator disclosure.

UPDATE:

The Second Circuit heard argument in this case in January 2011, but had not ruled as of a year later. In 2011, the same district judge who issued the arbitrator disclosure decision in *Scandinavian Reinsurance Co. v. St. Paul Fire & Marine Ins. Co.*, 732 F. Supp. 2d 293 (S.D.N.Y. 2010) (Judge Shira A. Scheindlin), handed down another noteworthy decision respecting proper conduct in a reinsurance arbitration, *Northwestern Nat'l Ins. Co. v. INSCO, Ltd.*, No. 11 Civ. 1124 (SAS), 2011 U.S. Dist. LEXIS 113626 (S.D.N.Y. Oct. 3, 2011). In this case, the court disqualified counsel for a party in a reinsurance contract arbitration based on that counsel's receipt and review of private arbitrator e-mail exchanges, including deliberations on disputed issues. Counsel had received the e-mails from one of the three arbitrators (the arbitrator its client had appointed). The court found that counsel's behavior amounted to a serious breach of his ethical duties. This decision has also been appealed to the Second Circuit.

10. Remain vigilant respecting potential new mass tort exposures. The potential for class action exposure in Europe has increased following the European Commission’s recently announced consultation on collective redress. Also, the U.S. Supreme Court granted *certiorari* in *Connecticut v. American Elec. Power Co.*, 582 F.3d 309 (2d Cir. 2009), a public nuisance case where the plaintiffs sought abatement of carbon dioxide emissions by the defendant power plants. The Court’s decision should signal the extent to which “global warming” claims can be pursued in court in the U.S. Follow-on insurance coverage litigation is a distinct possibility.

UPDATE:

In June 2011, the U.S. Supreme Court ruled in *American Elec. Power Co. v. Connecticut*, 131 S. Ct. 2527 (2011), reversing the Second Circuit’s decision reinstating a federal common law nuisance action brought by several states and other plaintiffs against five power company defendants to abate greenhouse gas emissions. The Court held that the action was displaced by the Clean Air Act and the EPA’s regulatory authority. Separately, the Virginia Supreme Court held in *The AES Corp. v. Steadfast Ins. Co.*, 715 S.E.2d 28 (Va. 2011), that an insurer did not owe its power company insured a duty to defend or indemnify respecting a global warming lawsuit brought by an Alaskan village. The court held that coverage under the subject CGL policy required an “accident,” and that damages allegedly resulting from the intentional release of greenhouse gases did not qualify as an “accident” under Virginia law. For more information, please [click here](#).

If you have any questions regarding this update, please contact the Sidley lawyer with whom you usually work.

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