NEW YORK DEPARTMENT OF FINANCIAL SERVICES: IMPLICATIONS FOR THE INSURANCE INDUSTRY

April 1, 2011

To Our Clients and Friends:

New York Governor Andrew M. Cuomo has signed into law a bill that consolidates the New York Insurance and Banking Departments into a new Department of Financial Services (the "DFS" or the "Department"). The DFS is to be overseen by a Superintendent whose powers are set forth in a new Financial Services Law ("FSL"). The law will take full effect on October 3, 2011.

While most of the New York Insurance Law and Banking Law remains in effect, the FSL provides the Superintendent with a new layer of enforcement and regulatory power over financial products and services. Among other things, focusing on the insurance industry, the new legislation:

- merges the two departments to establish the DFS, headed by the Superintendent, with an Insurance Division and a Banking Division as well as a Deputy Superintendent for each;
- creates a Financial Frauds and Consumer Protection Unit that is empowered to investigate financial fraud committed by insurers and other financial services entities as well as insurance fraud by claimants;
- extends the Superintendent's enforcement and rulemaking powers to previously unregulated financial products, services and entities;
- imposes new penalties, including a penalty of up to $5,000 per offense for financial fraud and other specified violations and $1,000 for violations of the FSL, while increasing the existing Insurance Law penalties;
- requires the Governor to appoint a working group that will consult with representatives of the insurance and banking industries and will develop by year end recommendations for more efficient and effective insurance and banking regulation; and

- provides funding of the DFS through assessments on regulated entities.

The portions of the Bill enacting the FSL, combining the departments and establishing the DFS will take effect on October 3, 2011. Until that date, both offices will still exist – Superintendent of Insurance and Superintendent of Banks. On or prior to October 3, the Governor is required to appoint a candidate for Superintendent of Financial Services, who will take office on October 3 if confirmed by the New York Senate prior to that date, or who will otherwise serve as acting Superintendent as of October 3 until Senate confirmation.

EXPANSION OF THE SUPERINTENDENT'S ENFORCEMENT AUTHORITY

The new legislation dissolves the Insurance Department Frauds Bureau and replaces it with the Financial Frauds and Consumer Protection Unit ("FFCPU"). Unlike the former Frauds Bureau, the FFCPU is empowered to investigate and pursue enforcement actions concerning financial fraud as well as insurance fraud as that term has long been used in the Insurance Law.

The FSL gives the Superintendent the power to impose civil penalties for (i) "any intentional fraud or intentional misrepresentation of a material fact" with respect to a "financial product or service"; (ii) any violation of state or federal fair debt collection practices or federal or state fair lending laws; and (iii) any violation of the FSL or regulations issued thereunder.

The term "financial product or service" encompasses any financial product or service "offered or provided by any person regulated or required to be regulated" under the Insurance Law or the Banking Law, as well as any financial product or service otherwise offered or sold to consumers, with certain exceptions. Excluded from this term are financial products or services that are (i) regulated "under the exclusive jurisdiction of a federal agency or authority;" (ii) subject to state regulation "for the purpose of consumer or investor protection by any other state agency, state department or state public authority" (e.g., securities, commodities and real property); or (iii) subject to preemptive federal regulation.

EXPANSION OF THE SUPERINTENDENT'S RULEMAKING AUTHORITY

The FSL gives the Superintendent significant authority to adopt regulations and issue informal guidance governing financial products and services. While the Insurance Law previously authorized the Superintendent of Insurance to "prescribe…regulations" under the Insurance Law, the FSL authorizes the new Superintendent to "prescribe…rules and regulations and issue orders and guidance involving financial products and services" effectuating the Superintendent's powers under the FSL, the Insurance Law or the Banking Law, to prescribe forms or make regulations, or interpret the FSL, the Insurance Law, the Banking Law or any other applicable law. This broad statutory language gives the Superintendent the authority to regulate previously unregulated financial products, services and entities so long as such regulations are not inconsistent with the FSL, the Insurance Law or the Banking Law.

FINANCIAL PENALTIES UNDER THE FSL AND THE INSURANCE LAW

The FSL establishes new financial penalties for financial fraud and violations of FSL regulations, and the budget legislation increases the existing financial penalties under the Insurance Law as follows:

- $5,000 per violation for financial fraud and/or violations of state or federal fair debt collection practices or fair lending laws;
- $1,000 for violations of the FSL or regulations issued thereunder; and
- effective April 1, 2011, $1,000 per violation for general violations of the Insurance Law (previously $500), and $500 per violation for acting as a producer without a license or aiding an unauthorized insurer in contravention of the Insurance Law.

Although these fines may overlap in certain circumstances, the FSL provides that "penalties for regulated persons under the insurance law shall be as provided for in the insurance law" and provides that the Superintendent may not impose a fine under the FSL that would be in addition to any penalty or fine for the same act or omission that is imposed under the Insurance Law.

ESTABLISHMENT OF A WORKING GROUP

The FSL requires the Governor to establish, by June 30, 2011, a working group "to examine ways to improve the efficiency and effectiveness of banking regulation and insurance regulation, including opportunities to integrate certain regulatory activities prescribed by the banking law and the insurance law. Such working group shall consult, in making its examination, with representatives of the banking, insurance and financial services industries." The Superintendent is required to submit a report to the Governor and Legislature by January 1, 2012.

ASSESSMENTS AND FUNDING

The Insurance Department and the Banking Department have long had statutory authority to assess regulated entities for the costs of running the respective Departments. The FSL clarifies the way in which the costs of running the new Department will, commencing April 1, 2012, be assessed against insurers and banks.

The FSL subjects insurers to two types of financial assessments. First, the Superintendent is required to assess persons regulated under the Insurance Law for the operating expenses of the DFS that are solely attributable to regulating persons under the Insurance Law. As was the case under the Insurance Law, such assessments are to be allocated *pro rata* to all domestic insurers and all licensed United States branches of alien insurers in proportion to their gross direct premiums written or received in New York. Second, the FSL provides that any operating expenses of DFS not directly attributable to the regulation of insurers and/or banks shall be assessed upon banks and insurers "in such proportions as the superintendent shall deem just and reasonable…." The FSL provides that penalties received by the Superintendent pursuant to the FSL shall be used to offset any such extra assessments on banks and insurers.

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If you would like more information on these or other topics of interest, please contact the undersigned or any insurance industry lawyer at Debevoise & Plimpton LLP.

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