

Upcoming Section Events

During its September meeting in Anchorage, Alaska, the Regulatory & Legislative Section Committee decided that the section would host two educational events at upcoming NAIC meetings.

The first session will be held during the NAIC's 2004 Winter National Meeting in New Orleans, Louisiana. The section will sponsor a hot topics roundtable. These roundtables have been very successful in the past. The section will try to secure a Saturday morning time slot for the session (December 4, 2004). Please check the NAIC meeting schedule for details. During the committee meeting, four hot topics were identified. Section members are recruiting speakers at the time this article was written. The topics are:

- the use of CLUE and other third-party databases in underwriting
- new ideas in alternative dispute resolution for medical liability claims

- the evolution of market conduct examinations into market analysis
- risk retention groups and captives

During the NAIC's 2005 Spring National Meeting in Salt Lake City, Utah, the section, in conjunction with the NAIC's Property and Casualty Insurance (C) Committee, will host a panel discussion on risk retention groups. There has been much controversy recently about risk retention groups. The insolvency of a major risk retention group that wrote contractual liability that insured auto and property warranties or service contracts issued by dealers or builders has left many contract holders without benefits or remedies. In addition, the General Accountability Office (GAO) was asked by Congress to evaluate how the Liability Risk Retention Act (LRRA) is performing. The GAO report is due to be released during the first quarter of next year. There are also some areas of contention among states regarding risk

retention groups. There is at least one instance where one state has disagreed with another state's finding that a particular group is a risk retention group. The issue related to a finding by the other state that the risk retention group's members were not involved in a related business consistent with the requirements of the LRRA. In addition, section member Cliff King (NV) raised an issue concerning a Nevada risk retention group that was facing a cease-and-desist order and was able to avoid it by changing its domicile to another state. All of this controversy should lead to a very interesting session where interested persons can learn about risk retention groups and gain some insight into how they are regulated. Watch for further details to come.

We look forward to your attendance at these education events. ■

Highlights from the NAIC's Meeting in Anchorage

This article presents some highlights regarding the September 2004 NAIC meeting in Anchorage, Alaska that might be of interest to section members.

Asbestos Legislation

The Property and Casualty Insurance (C) Committee continues to monitor progress on Congressional negotiations related to legislation to establish a trust fund to compensate victims of asbestos exposure. Senate leaders continue to discuss asbestos litigation reform measures and are closer than ever to reaching accord. The NAIC remains neutral on the

legislation and has served as an information source during the debate.

Auto Insurance Anti-Fraud Bill

The Property and Casualty Insurance (C) Committee discussed S. 2728 (the Cheaper Car Insurance Act of 2004 a bill to enact several auto insurance antifraud measures). The bill does not appear to be on a fast track in Washington, DC. The Texas Insurance Department developed comments on the bill and distributed them to the committee.

Class-Action Litigation

The Property and Casualty Insurance (C) Committee's Class-Action Insurance Litigation Working Group did not meet during the quarter. The working group is awaiting word from the RAND Institute for Civil Justice regarding its study of class-action insurance litigation. A white paper on the topic is under development.

Crop Insurance

The Property and Casualty Insurance (C) Committee's Crop Insurance Working Group did not meet during the quarter.

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There have been conversations with representatives of the Federal Crop Insurance Corporation's Risk Management Agency (RMA). An information-sharing agreement has been developed for states and RMA to share regulatory information. The agreements are similar to those that were developed for the federal bank regulators and the states. States were presented with the agreements at the Anchorage Commissioner's Roundtable and were asked to sign them as soon as they can. NAIC legal staff is working on another agreement between the RMA and the NAIC to share some of the information contained in NAIC databases. RMA will provide disbarment information to the NAIC. The agreements have been developed as an outgrowth of the American Growers' insolvency. The RMA is in a unique role as both a regulator and a reinsurer. Coupled with the fact that crop insurance contracts cannot be cancelled once issued, there is a real need to stay on top of crop insurance writings by reinsured companies. Of great concern is how to allocate resources of a multi-line insurer that also writes crop insurance, if it becomes insolvent.

Flood Insurance

The Property and Casualty Insurance (C) Committee's Catastrophe Insurance Working Group is evaluating the impact of Senate Bill 2238, a recently enacted law that reauthorizes the Federal Flood Insurance Program, with some specific changes and mandates. Among the key provisions concerns a pilot program to mitigate repetitive flood insurance losses. The revised law also requires the Federal Emergency Management Agency (FEMA) to establish minimum training and education requirements for insurance agents. The working group is discussing the role of the states and FEMA in developing and implementing a program that meets the obligations in the statute. Initial plans call for FEMA to develop basic instructional materials. The states will be involved in the implementation of the education requirements. A survey will be conducted by the NAIC to evaluate

the extent to which states have included flood insurance questions in licensing examinations and the availability of continuing education related to flood insurance.

Market Conditions

The Property and Casualty Insurance (C) Committee's Market Conditions Working Group had its Medical Malpractice Report adopted by Executive/Plenary in Anchorage. It is now available to the public. The working group's next endeavor will be to study property insurance. The working group plans to concentrate on commercial multifamily dwellings. NAIC staff was asked to look at availability and affordability issues and risk mitigation. Differences between urban markets and suburban or rural area will also be studied.

Risk Retention Groups

The Property and Casualty Insurance (C) Committee's Risk Retention Working Group discussed several agenda items. The working group discussed the formation of a Risk Retention (E) Subgroup to investigate issues related to financial oversight of risk retention groups. At issue is whether risk retention groups that are formed, as captives are included in the formal Financial Analysis Working Group process. In addition, whether Part A of the Accreditation Standards applies to all risk retention groups was considered.

The working group heard a report on progress made by the Government Accountability Office (GAO) in its study of risk retention groups and related activities. The report should be issued in early February 2005. Notably, 50 of the 51 jurisdictions surveyed had responded to the GAO survey request.

A draft risk retention issue paper is under development, but not ready for distribution. The working group plans to wait for the GAO report before a decision is made to complete it.

There are some areas of contention among states regarding risk retention groups. Commissioner Larry Mirel (DC) advised that there was at least one

instance where a state has disagreed with the District of Columbia's finding that a particular group is a risk retention group. The issue related to a finding by the other state that the risk retention group's members were not involved in a related business consistent with the requirements of the Liability Risk Retention Act (LRRRA). Commissioner Mirel believes this action was inconsistent with the intent of the act. In addition, Cliff King (NV) brought to the attention of the working group an instance where a Nevada risk retention group was facing a cease and desist order and was able to avoid it by changing its domicile to another state.

The working group received a report on the status of National Warranty. Claims are not being paid and a significant court case has been filed.

Terrorism Insurance

The Property and Casualty Insurance (C) Committee's Terrorism Insurance Implementation Working Group met, appropriately, on September 11, 2004. The members discussed whether regulators need to determine how often insurers should check for compliance with the Office of Foreign Assets Control's (OFAC) Specifically Designed Nationals and Blocked Persons (SDN) regulations. The OFAC administers and enforces economic and trade sanctions based on United States foreign policy and national security goals. The regulations prohibit insurers from providing any services (policies, claim payments, etc.) to any person on the SDN list. The working group recommended that since the issue impacts insurers other than property and casualty insurers, the concern should be presented to the NAIC's officers to determine what committee should address the issue.

The working group also discussed long-term market solutions to replace the backstop provided under the Terrorism Risk Insurance Act (TRIA). The United States Congress passed TRIA as a temporary measure to maintain insurance coverage for acts of terrorism while the insurance industry found a long-term

market solution. Members expressed concern that insurers have not been actively working on any solutions to replace TRIA when it expires in two years. While the working group acknowledged that because of the complexity of the issue, there might never be a solution completely funded by the insurance industry, the members expressed interest in working with the insurance industry to discuss possible solutions.

Title Insurance

The Property and Casualty Insurance (C) Committee's Title Insurance Issues Working Group heard a report from Jackson Williams (Public Citizen's Congress Watch). Williams was concerned that the NAIC's Title Insurer Model Act did not have enough significant consumer protections within it. He encouraged the working group to consider options or alternatives that would provide a better value to consumers. He was particularly concerned with refinanced mortgages. He believed that it was inappropriate for title insurers to issue a complete policy without a discounted rate since the title insurer was only assuming the risk of title defects for the period between the time the original mortgage was issued and the issuance of the refinanced mortgage.

Vice Chairman Lam Nguyen (OK) presented three white papers that he had drafted for consideration by the working group. He asked members and interested parties to be ready to discuss and act upon the white papers during an upcoming interim conference call.

The working group listened to a presentation from Ivy Jackson (HUD), director of RESPA and Interstate Land Sales. Jackson encouraged regulators to work closely with the Department of Housing and Urban Development (HUD) to assure that consumers are not disadvantaged in real estate transactions. Jackson described some of the scams that HUD has uncovered. She encouraged states to share information with HUD when it discovers RESPA violations. The working group adjourned to executive session to discuss possible information

sharing agreements between the states and HUD.

Speed to Market

The Speed to Market (EX) Task Force met in Anchorage without a quorum present. There has been some controversy regarding its charge to discuss and recommend to the Property and Casualty Insurance (C) Committee an appropriate regulatory framework for personal lines rates. This discussion has taken place in the Operational Efficiencies Working Group. The charge dates back to 2000 when the Statement of Intent was adopted. Washington has raised an objection to having the discussions about the personal lines regulatory framework held in the working group. Commissioner Kreidler thinks that the issue should be discussed at the task force level because it related to public policy more than operational efficiencies. The task force adopted recommended charges that would move this issue to the task force. This was done without benefit of a quorum and without the task force chairman in attendance. Commissioner Walter Bell (AL) was absent as a result of an early return to Alabama because of the impending hurricane.

Operational Efficiencies

Alaska now has joined with the seven other states in the Self-Certification Pilot Program. Statistics gathered by the pilot states have recently been enhanced, anticipated to lead to better analysis of the program in the near future. The Association of Insurance Compliance Professionals (AICP) has been helpful in promoting the self-certification pilot effort by developing a hyperlink that provides immediate access for its members to the NAIC self-certification pilot program web site.

The working group adopted various suggested changes to operational efficiency tools to become effective January 1, 2005. A revision of the Uniform Property and Casualty Product Coding Matrix auto section was adopted, which greatly simplified its use by essentially placing auto coding under Personal Auto or Commercial Auto Lines of Business (allowing more coding by

coverage combinations). Also adopted were suggested additional codes under medical malpractice. The Interstate Compact National Standards Working Group had suggested numerous changes to the sections for life insurance and annuities and some changes to the disability income and long-term care insurance sections, which were all adopted by the working group.

The working group received a survey completed by the AICP soliciting feedback from its members regarding the NAIC Uniform Product Coding Matrices. The working group decided that since the members had not had an opportunity to previously review the survey that it would be discussed during a forthcoming conference call.

Virginia has implemented the Property and Casualty Product Requirements Locator. The NAIC has begun efforts to migrate the operation and maintenance of the Product Requirements Locators from the Ohio Department of Insurance's automated systems.

The working group received an update on development of the *Product Filing Examiners Handbook*. It was reported that several chapters have now been drafted and that a target date for completion of a draft handbook has been set for the NAIC 2005 Spring National Meeting. ■

Credit Scoring Study on Hold

The National Association of Insurance Commissioners (NAIC) announced that an agreement was reached on August 4, 2004, between states involved in an ongoing credit scoring study and the major associations representing the property and casualty insurance industry, with the states deciding to suspend their "multi-state study" in exchange for the industry agreeing to provide data and to support the collaboration between state and federal regulators for a Congressionally-mandated study on the same topic. Under the agreement, the officers of the NAIC will appoint a five-member state panel to work with the Federal Trade Commission (FTC) and the Federal Reserve Board to analyze industry data and make findings as to the actuarial validity of credit scoring and its impact on various demographic groups.

"This is a win-win proposition for consumers and the industry," said Scott B. Lakin, director of insurance in Missouri, the lead state in what was the multi-state study. "Independent researchers will have access to the data needed to answer the important questions that state insurance officials have been asking about the effect of credit scoring on consumers, and the industry can keep its administrative burdens to a minimum."

Noting that federal regulators would retain the data collected and have final responsibility for the findings reported back to Congress, Lakin said he was confident that the collaborative effort would be successful. "If not," he added, "the states have reserved the right to renew our multi-state study."

"I'm pleased that the NAIC leadership can play a role in bringing the parties together on a contentious issue such as credit scoring," observed Joel Ario, insurance administrator in Oregon and secretary-treasurer of the NAIC. "We look forward to implementing this agreement by appointing a fair and balanced panel of state regulators to work with the FTC."

The FTC study is being designed pursuant to Section 215 of the Fair and Accurate Credit Transactions Act. The Act calls for a final report to Congress by December 2005. ■



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Moving Toward Balance in Workers Compensation Residual Markets

by James R. Nau, CPCU, ARM



■ **James R. Nau, CPCU, ARM**, is general manager of residual markets for the National Council on Compensation Insurance. Nau also served as the 2002-2003 president of the CPCU Society.

The year 2003 was notable for a move toward balance in the workers compensation residual markets serviced by the National Council on Compensation Insurance (NCCI). Residual market total written premium grew by 27 percent to \$1.4 billion in 2003. This is significant growth but less than the rate of growth in each of the years since 1999. In addition, the pattern of new business seeking residual market coverage began to change in the second half of 2003. At that time, the number of new applications continued to grow by 15 percent. However, the premium bound for those new applications decreased by 5 percent over the prior year. That pattern continued in the first half of 2004.

The most important measure of balance in the workers compensation residual market is the operating result. The 2003 projected operating loss for all pools serviced by NCCI is \$180 million. NCCI's goal is to implement the appropriate mix of rates, rating plans, loss prevention programs, effective financial management, and antifraud activities to achieve self-funded residual market reinsurance mechanisms. Thanks to these activities, the operating loss represents only 1.7 percent of the total voluntary premium. However, NCCI's goal is to achieve self-funded residual markets. Therefore, NCCI is focusing attention on several states that have generated high operating losses.

NCCI continues to automate processes in order to deliver the best possible service to residual market policyholders, claimants, and carriers. In 2003, NCCI implemented the Servicing Carrier Selection and Oversight System (SCSOSSM) Service. The system uses a web-based approach to conducting servicing carrier bids and awarding contracts. NCCI also established the Electronic Data Transfer program that will permit NCCI to send new application information electronically to the residual market carriers. This will reduce communication time and enhance service quality. In addition, NCCI automated the Take Out Credit Program. The new system will automatically calculate annual Take Out Credits for all participating insurers. The program will eliminate time-consuming and costly manual compilations and will ensure a fair application of Take Out Credits to all qualifying participating insurers. Finally, NCCI continued to refine and improve the quality and timeliness of residual market data published on the NCCI web site. NCCI has also expanded the data available to all interested parties in order to improve the understanding of residual market issues and demographics.

There are two major issues that could have a significant impact on the reinsurance pools in the near future. These are the risk of insurance company insolvencies and the risk of terrorism.

NCCI has developed and is actively enforcing a workers compensation reinsurance pool credit policy to obtain security toward a participating insurance company's financial obligations to the National Workers Compensation Reinsurance Pool (NWCRP). Security requirements are determined based on A.M. Best ratings and IRIS ratio results. NCCI is currently holding \$99 million to secure its obligations, for the benefit of the NWCRP participants.

NCCI staff and the NWCRP Board are also working together to understand the concentration of risk in the workers compensation residual market by collecting and analyzing demographic information and working with appropriate parties to implement the Terrorism Risk Insurance Act of 2002 regulations and to prepare for any post-TRIA environment.

Conclusion

Workers compensation residual markets continued to grow in 2003. Despite this growth, NCCI and its assigned carriers have been able to meet the challenges that presented themselves, maintain the financial stability of the reinsurance pools, and provide prompt and valuable services to all residual market stakeholders thereby moving toward balance in the residual markets. ■

What Qualities Do Lawyers Value Most When Selecting an Insurance and Reinsurance Litigation Consultant?

by Andrew J. Barile, CPCU



■ **Andrew J. Barile, CPCU**, CEO of Andrew Barile Consulting Corporation, Inc., with 40 years of experience in the property-casualty insurance industry, co-founder of the first publicly held Bermuda reinsurer, is on the board of both domestic and offshore insurance companies. He has an MBA from Stern's (NYU) business school, and won the Anglo-American Fellowship to study at Lloyd's of London, with his thesis on the captive insurance company. He can be reached at abarile@abarileconsult.com.

Introduction

Insurance agents, insurers, and reinsurers are spending more money and devoting more resources on legal services and insurance advice than ever before. More companies are embroiled in legal disputes or being sued.

As an insurance and reinsurance litigation consultant, a reinsurance arbitrator, a reinsurance expert, and having 40 years of insurance experience as a wholesaler, MGA, insurer, reinsurance broker, reinsurer, both domestic and in Bermuda, I want to reveal how companies and their law firms are dealing with the increase in litigation and what qualities are of most value when the lawyers are selecting an insurance and reinsurance litigation consultant.

Qualities of an Insurance and Reinsurance Litigation Consultant

(in order of importance)

1. expertise/ability
2. knowledge of the insurance and reinsurance industry
3. responsiveness
4. value of the case (monetary value)
5. honesty/transparency
6. reputation/professionalism
7. reliability
8. promptness
9. efficiency
10. longstanding/relationship

Litigiousness Increasing

Companies have experienced an increase in litigation in recent years, not only in the United States, but also in Europe. In-house counsel has seen an increase in litigation and, understandably, are alarmed by the increase. The concept of finding more people being prompted to file a claim is increasing worldwide. We find more often that U.S. lawyers are pursuing litigation possibilities outside the United States.

Outsourcing Legal Work

More insurance companies and reinsurance companies are finding it more cost-effective to outsource their legal work to law firms to cope with the rise in litigation. It's certainly easier to control by outsourcing. In talking with lawyers, you can come to the conclusion that litigators handle litigation and arbitration better than the in-house staff can. Retaining local lawyers from the country in which they have legal problems is the smarter way to go. Only with the Internet can this work be cost-effective. You needn't fly around the world the way we did years ago.

Searching for the Ideal Insurance and Reinsurance Litigation Consultant

In-house legal counsel from insurance and reinsurance companies around the world are constantly asking their law firms to improve their service and are requiring:

- a more prompt turnaround
- increasing the amount of research on a case
- more regular updates
- in cases of court cases, a more thorough preparation
- understanding the treaty reinsurance agreement
- understanding the Arbitration Clause

All of these requirements have burdened the litigation lawyer with the major issue of selecting the appropriate expert that has the expertise and ability within the insurance and reinsurance industry. The insurance and the reinsurance industries are very complex, and locating the right litigation consultant with the right knowledge is very difficult.

Insurance and reinsurance litigation consultants can stay current by attending the NAIL, the AAMGA, the NAPSLO, the NAIC quarterly meetings, the PriceWaterhouse, Standard and Poors, and A.M. Best conferences. Reading numerous insurance periodicals and attending the CPCU Society's Annual Meeting and Seminars are an important part of the schedule of a responsive insurance expert.

The consultant must give quality advice, and most law firms are focusing on value for money rather than hourly rates.

In an increasingly litigious society, insurance and reinsurance law firms seem to be working in closer partnership with their insurance and reinsurance litigation consultants than ever before, relying on the consultant to deliver the service they expect. ■

Providing Strategic Insurance Industry Consulting Services to Institutional Investment Firms

by Andrew J. Barile, CPCU

The institutional investment firms, commonly referred to as capital management firms, have significantly grown in number over the last several years. The analysts at these investment management firms need answers to significant technical comments being made by executives of insurers and reinsurers, especially when the institutional investor has a significant equity position in the property and casualty insurance company, and needs a good deal of answers to his/her questions.

More and more, analysts are utilizing the consulting services of the industry consultant to provide them with important information, and to clarify their questions.

Since most of the work is done with confidentiality agreements, analysts are protected with complete confidentiality.

The portfolio managers at the institutional investment management firms need a good deal of more specific information when it comes to the insurance and reinsurance industries. One example is when one publicly held Texas insurer owns stock in another Texas publicly held insurer, and each begins to reinsure each other under various terms and conditions, revealed in the Form 10-Q. What are the financial implications of these type of events? The portfolio manager must understand them.

The registered investment advisor who specializes in the financial services industry needs more detailed information than can be obtained by simply reading the prepared press releases of the publicly held insurers regarding their loss amounts due to hurricanes. Are those gross losses, before collectible reinsurance, or net losses? Did the carrier really buy enough reinsurance catastrophe protection? Should I own 500,000 shares of that insurance company's convertible preferred stock because of its Florida catastrophe exposure?

Directors of Publicly Held Insurers and Reinsurers

What is the investment management firm's reaction to the following, "Mr. X was recommended for consideration by a current member of the Board of Directors and approved by the nominating committee. See related party transactions."

What about the comments, "He was recommended for consideration by a board member or by a third-party insurance industry search firm and approved by the nominating committee."

Analysts should be seeking more aggressive directors for the insurance industry.

Do investment management firms want to begin nominating their own insurance company Board of Directors? Should the board have business school professors who never were active in the industry? Most professors lack the actual experience in the insurance industry. The practitioner of insurance makes a better director than the academic type, only because the practitioner understands the financial implications of the comments being made, as well as the "politics" of the situation.

Serving on current board of insurance companies is a challenge because CEOs do not want interference with their ability to make decisions. That is how they were able to rise to CEO of the insurance company. Most act, then ask for director comments. Analysts must begin to understand this management style of insurers.

Why Use Insurance Industry Consultants?

The experienced insurance industry consultant provides new, fresh perspectives, a sense of independent thinking, and, of course, deep insurance industry knowledge. The consultant has practical hands-on experience.

Investment management companies retain the insurance industry consultant because of his or her comprehensive insurance industry contacts and firm grasp of insurance industry trends. Remember, this is a highly specialized industry. Attending the American Association of Managing General Agents convention, the National Association of Surplus Lines Producers convention the CPCU Society's Annual Meeting and Seminars, the Big "I" convention, the Property and Casualty Insurers convention, the National Association of Mutual Insurance Companies convention, the National Association of Insurers Commissioners convention can give the industry consultant a significant advantage when formulating ideas of what's really going on in the insurance industry. The International Insurance Society's Annual Meeting is a must. Access to the top executives of insurers can give the consultant a significant advantage.

Conclusion/Some Concepts to Think About

Will institutional investment firms worldwide demand Board of Director positions in the future? How does the institutional investment firm react to the class-action lawsuit in which it is a very significant investor? Are the firms going to take a more active role in the management of the insurer and reinsurer? In the aggregate, institutional investors play a very important role in the ownership of property and casualty insurers in the United States; will that role become even more active in the future? ■

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Regulatory & Legislative Section Quarterly
is published by and for the members of the Regulatory
& Legislative Section of the CPCU Society.

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Printed on Recycled Paper



Regulatory & Legislative Quarterly

RLQ

Volume 12

Number 3

November 2004

CPCU Society
720 Providence Road
Malvern, PA 19355-0709
www.cpcusociety.org

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