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An Industry Under Siege

by Damian V. Sepanik, J.D., CPCU

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Is more federal oversight of the financial dealings of the insurance industry inevitable? Is the industry just a convenient political target or an industry crying out for regulatory overhaul? The issues that shape this debate are not necessarily new, but have been brought out under a new light in the wake of the headline-grabbing allegations of "corrupt practices in the insurance industry" (*The Wall Street Journal*, October 20, 2004).

Is federal regulation really that novel a concept? As a result of the McCarran-Ferguson Act, insurance is regulated by the individual states. Right? It's not so clear any more. And to what extent it remains under state purview is even a bigger question.

The federal government has encroached more and more into areas that traditionally have been strictly the state regulator's domain. For example, at the very end of the Clinton administration, there was a fierce battle to allow OSHA to force ergonomic standards on employers and to force insurers to pay benefits that were in conflict with state workers compensation laws. That effort was defeated soon after the Bush administration settled in, but it did not go away quietly and could return.

The Gramm-Leach-Bliley Act blurred the line between what insurance is and is not, and which activities would continue to be within the purview of state insurance regulators versus federal bank regulators.

The little known Federal Crime Act prohibits insurers from doing business with or employing anyone convicted of a felony related to fidelity (basically lying, cheating, and stealing).

The Terrorism Risk Insurance Act (TRIA) provided a sort of reinsurance safety net to preserve the insurance and reinsurance markets in the aftermath of September 11.

Similarly, Congress has been wrestling with finding a way to finance the out-of-control and ever-growing payments made to those exposed to asbestos. Asbestos claims have already forced the demise of a host of household-name corporations. The burden on their insurers continues to be a tremendous strain, already forcing a number of them into receivership and will likely take more down unless reform is implemented.

Congress has recently circulated a draft of the State Modernization and Regulatory Transparency (SMART) Act, 300-plus pages of the federal view of the coordination of insurance regulation.

One federal law in particular that I believe has had and will continue to have a profound impact on the insurance industry is the Sarbanes-Oxley Act of 2002. Now, Sarbanes-Oxley is not insurance legislation. It was a reaction to several high-profile corporate collapses at the beginning of the new century—Enron, WorldCom, and Tyco to name a few. Fraud was rampant in these organizations and it was clear that existing law did not protect shareholders sufficiently. "Results management" was a widespread and basically accepted corporate practice.

In a nutshell, Sarbanes-Oxley requires more transparency and real-time reporting of important corporate events. It also imposes a number of common-sense ethical requirements on publicly traded companies.

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Let me briefly go through the highlights of the law:

- Intent: Restore investors' faith in the investment markets. Impose ethical constraints.
- Requires CEO/CFO certifications of financial statements.
- Bans certain loans to officers and directors.
- Requires the forfeiture of bonus and profits in event of restatements caused by misconduct.
- Requires the disclosure of any material correcting adjustments.
- Requires the rapid reporting of insider trades and material changes in financial condition.
- Requires the disclosure of off-balance sheet transactions (financing that does not add debt on the balance sheet and thus does not affect borrowing capacity as determined by financial ratios, i.e. operating lease rather than capital lease).
- Requires the disclosure of audit committee financial expert.
- Requires the disclosure of whether a code of ethics for senior financial officers has been established.
- Makes violations felonies.

Okay. So what is the impact on insurers? And why should I care if my company is closely held or is a mutual? In a nutshell, public perception and the dynamics between state and federal regulation will demand that you care. Whether it technically applies to a business or not, Sarbanes-Oxley has become the de facto standard to which business practices are measured.

To the public, the insurance industry is often viewed with confusion and skepticism. For starters, the way insurance companies keep their books is different than other businesses. First of all, they are legally required to keep at least two sets of books, one utilizing statutory accounting, and the other utilizing GAAP accounting. This may make sense to insurance regulators, but not necessarily to the public.

Second, insurance companies are prone to basing many of the most important numbers in their financial statements on educated guesses. As my friends who are actuaries have advised me, the setting of reserves is an art, not a science.

What is not unique to insurers is the constant pressure to perform at expected levels. If you work for a publicly traded company and your CEO is paid based on success measured by market value, you can bet that every quarter, there is extreme pressure to have the numbers come in at a predictable level. Any adverse surprise not only impacts the stock price of the company but also the financial rating. A negative financial rating hit means more operating expense in running the company, putting even more pressure on meeting expected results. As if this wasn't enough pressure, looking over the other shoulder of the CEO are the rating agencies. These are the guys with the real power. An adverse rating change can and has put companies under.

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So how could this work in real life? Let's say a hypothetical company has very significant negative reserve adjustment that is becoming more and more obvious. The CEO knows the company has to take the hit at some point. Then lo and behold, four hurricanes hit Florida in the same month. Lots of claims—the quarter is shot anyway—the market is expecting losses—why not take the asbestos reserve hit now as well? As a matter of fact, our physician book needs some help; let's throw that in too. Is there anything illegal with this? Maybe—maybe not. Is it common? Yes. It's so common that it has names like bathtub and kitchen-sink reserving. Collectively, it's called results management. Does it impact the ability of an investor or insurance consumer from making a good decision about the company? You bet it does. (For an interesting discussion of these issues, see the February 7, 2002, Morgan Stanley Equity Research report entitled "Bonfire of the Beancounters.")

Another reason that you should care about this even if you are not a publicly traded company is that the NAIC is currently working to incorporate Sarbanes-Oxley-like standards into state insurance regulation. The current version of the NAIC model would require all but the smallest mutual and privately owned companies to comply with strict disclosure and control requirements. Anyone familiar with the NAIC reaction to the Gramm-Leach-Bliley financial privacy requirements will expect the NAIC rules to be even more encompassing than Sarbanes-Oxley.

Add to this mix the recent headlines of allegations of contingent commission improprieties and bid rigging, and you have an interesting political dynamic that can only bring more attention to accounting issues unique to the insurance industry. For example, in the wake of these headlines came a number of statements from insurers and others regarding the use of certain insurance products used to "burnish results." This movement from criticizing insurance company accounting practices to questioning the use of certain insurance products to manage the results of companies that purchase these products could have a profound and wide-ranging impact on the insurance industry for years to come. *The Wall Street Journal* reported on November 17, 2004:

> New York Attorney General Eliot Spitzer told federal lawmakers that Congress needs to look into the insurance industry's 'Pandora's box' of problems, saying that lack of federal oversight and disclosure has padded consumers' insurance costs.

Since financial regulation is currently within the purview of individual state insurance regulators, criticism of lapses in this regulatory oversight has already ignited calls for the federal regulation of

insurance company financial matters. A recent article in *The Wall Street Journal* said that one of the "scandal repercussions" is that the "wide probe spotlights a sometimes feckless regulatory apparatus" (*The Wall Street Journal*, October 18, 2004).

Ironically, it may not only be the state or federal government that slows this activity down; it may also be market forces. Berkshire Hathaway, for example, has in the past publicly criticized many of these financial practices and has stated that it will not delay posting reserves and that results will accurately portray the point-in-time financial condition of the company. The company is, in fact, using financial transparency as a marketing advantage. Such peer pressure may make companies that continue the practice of results management to stand out against their competitors.

> *. . . it has been critical that, as CPCUs, we help educate the public about our industry.*

What the industry and the way it is regulated looks like after all of the dust settles is the subject of spirited debate. When I entered the industry 18 years ago, a more experienced colleague told me "these are interesting times to be in the insurance industry." I cannot recall a time since then that has not been interesting, but the pressures today are quite remarkable. Throughout these times, it has been critical that, as CPCUs, we help educate the public about our industry. For my part, that is exactly what I hope to do. ■

Spotlight on Co-Chairman Damian V. Sepanik, J.D., CPCU

Editor's Note: As part of an ongoing effort to allow our members to get to know more about their section leadership, the *RLQ* will begin a series of articles profiling the background and interests of members of the Regulatory & Legislative Section Committee.

Damian V. Sepanik, J.D., CPCU, has a rich insurance and regulatory background. After receiving a business undergraduate and an M.B.A. degree, he earned a law degree from the John Marshall Law School in Chicago. Upon graduation, Sepanik joined the Law Department of the CNA Insurance Companies. There, he held a number of executive-level positions during his 17-year career with the company. These positions included general counsel roles with both the CNA personal lines and large commercial lines businesses. In addition to his responsibility for U.S. legal matters, Sepanik was responsible for legal matters arising from CNA's Bermuda operations. *(Editor's Note: The editor expects that this was one of Damian's favorite assignments.)* Sepanik was the senior managing attorney of the in-house insurance coverage litigation firm Sepanik, Cortner, McNaboe, Colliau & Elenius. He was also responsible for financial regulation while at CNA and has been a regular attendee of the NAIC national meetings for the last 15 years.

Sepanik is now a member of The Law Offices of Damian V. Sepanik, LLC, a boutique law firm located in Barrington, Illinois, focusing on insurance regulation. Sepanik provides legal counseling and insurance regulatory consulting services to clients internationally.

Sepanik is a frequent writer and lecturer on insurance topics. He is co-chairman of the CPCU Society's Regulatory & Legislative Section Committee and was a speaker at the recent 2004 CPCU Society Annual Meeting and Seminars. Sepanik is also president of the Insurance Regulatory Examiners Society Foundation. The IRES Foundation is dedicated to providing financial support for educational initiatives of the Insurance Regulatory Examiners Society. The IRES Foundation hosts the popular National Insurance School on Market Regulation annually, and Sepanik is a major contributor to its huge success.

As co-chairman of the section, Sepanik is always interested in feedback from section members. Any comments or ideas about how your membership in the Regulatory & Legislative Section can be enhanced are welcome and can be directed to him at (847) 277-1092 or at dsepanik@direcway.com. ■

The Latest News on Broker Disclosure

During a conference call of its membership on December 29, 2004, the NAIC adopted model legislation that would implement new disclosure requirements designed to ensure consumers are provided the information necessary to understand the manner in which brokers are compensated for the sale of insurance products. The model legislation amends the NAIC's current Producer Licensing Model Act and is a key component of an aggressive initiative by state insurance regulators to address issues surrounding the use of compensation arrangements by insurance brokers.

The members also directed the NAIC's Executive Task Force on Broker Activities to give further consideration to the development of additional requirements, such as recognition of a fiduciary responsibility of producers, disclosure of all quotes received by a broker, and disclosures relating to agent-owned reinsurance arrangements.

"We made a promise to consumers and industry to get to the bottom of this matter as quickly as possible, resolving to develop and put into place a tangible action plan for state insurance regulators," said current NAIC President and Pennsylvania Insurance Commissioner Diane Koken, who also chairs the task force. "With passage of this model legislation, we are delivering on that promise."

The recent action emanates from the work of the NAIC's Executive Task Force on Broker Activities, whose members have moved quickly to implement a three-part action plan that includes: creating more transparency for insurance consumers through better disclosure of broker compensation arrangements; continuing to help state insurance regulators coordinate efforts to address improper conduct by brokers and insurers through investigation and collection of relevant information; and the implementation of a new online fraud reporting system.

Among the requirements contained in the model legislation, brokers would be required to disclose the amount of compensation from the insurer and the method for calculating the compensation, including any contingent compensation. In those cases where the contingent commission is not known, brokers would be required to provide a reasonable estimate of the amount and method for calculating such compensation. Producers who represent companies and do not receive compensation from customers would have a duty to disclose that relationship in certain circumstances. (A draft of the model legislation is available for review on the NAIC home page at www.naic.org.)

The NAIC held a public hearing at its 2004 Winter National Meeting held earlier in December to receive public comment on the proposed language, committing to adopt model disclosure language by the end of the year. ■

Upcoming Section Event

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 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) surfaced an issue 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. 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 this educational event. ■

Highlights from the NAIC's Meeting in New Orleans

by Eric C. Nordman, CPCU, CIE

Eric C. Nordman, CPCU, CIE, is director of research with the National Association of Insurance Commissioners.

This article presents some highlights from the December 2004 NAIC meeting in New Orleans, Louisiana, 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. There has been a new discussion draft of the Fairness in Asbestos Injury Resolution Act of 2004 that is being circulated in the Senate. The draft draws on many provisions from earlier versions of the bill. It does not address the size of the fund, the upfront loading issues, the total number of years that the fund will be in existence, or what happens in the event of bankruptcy of the trusts. NAIC staff believes that the purpose for the draft is to keep momentum for 2005, when Congress will have to introduce a new bill.

Class-Action Litigation

The Property and Casualty Insurance (C) Committee's Class Action Insurance Litigation Working Group heard several reports during the meeting. NAIC staff reported that the study that is being conducted by the RAND Institute for Civil Justice was lagging, as data were not coming in as quickly as originally anticipated. A presentation from RAND is expected during the NAIC 2005 Spring National Meeting. Staff advised that some drafting work had been completed on the working group's white paper. Sections on the history and regulatory framework are complete. The first draft of the white paper is expected during the 2005 Spring National Meeting.

The working group heard reports from Robert Zeman (PCI), David Snyder (AIA), Steve McManus (State Farm) and Phillip Stano (JordenBert). Zeman provided an update on the need for state class-action litigation reform. He identified four areas where legislation would be helpful to insurers and regulators. These include:

- Creation of a rebuttable presumption that approval of a product by a regulator should be considered valid unless compelling evidence suggests otherwise.
- Requiring courts to dismiss or hold a case in abeyance if there is an administrative remedy that has not been exhausted.
- Granting a stay of discovery while a motion to dismiss is pending.
- Limitation on the size of appellate bonds.

Snyder discussed the prospects for passage of the Class Action Fairness Act of 2003. Snyder observed that there was a reasonable likelihood of its passage in 2005 because of broad-based bipartisan support. The legislation would help rationalize coupon settlements, provide mandatory notice to public officials, and move class actions to federal courts when there are national implications to the outcome.

McManus presented updates on three class actions related pending for State Farm. Updates were given on *Hill v State Farm* (dealing with distribution of State Farm's surplus to policyholders), *Nakashima v State Farm* (a New Mexico case related to an allegation that installment payment fees were required to be filed as part of the rating system and in accordance with rating laws), and *Gilchrist v State Farm*, et al (alleging antitrust violations related to after-market crash parts). State Farm is confident that it will prevail in all three cases; however, millions of dollars had been spent defending these actions.

Stano provided an update on several modal premium cases that are occurring in New Mexico. Issues include lack of appropriate disclosure to policyholders and whether additional fees collected on installment payments are really interest payments that would require disclosure of the annual percentage interest rate by the insurer in accordance with the Fair Credit Reporting Act.

Consumer representatives spoke regarding what they believed was a one-sided approach to evaluating class-action litigation.

Crop Insurance

The Property and Casualty Insurance (C) Committee's Crop Insurance Working Group met in New Orleans. The working group heard a report from Ross Davidson (RMA) related to activities of the Federal Crop Insurance Corporation's Risk

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Management Agency (RMA). He advised that the RMA had completed its negotiations with all of its insurers related to the Standard Reinsurance Agreement. He announced that three new insurers had entered the market. Also one multi-line insurer (the Hartford) has decided that it will no longer write crop insurance business.

Davidson discussed an information-sharing agreement that the RMA is rolling out to states. He added that in addition to the state agreement, an information-sharing agreement has been entered into by the RMA and the NAIC. He added that there are many new products that have been developed in the crop insurance area.

Davidson announced that Arkansas Commissioner Mike Pickens has been appointed to the RMA Board of Directors.

Davidson encouraged states to work together to develop common licensing and continuing education requirements. He also urged states to move toward uniformity in licensing insurance adjusters. He pledged RMA's support to discuss and implement the uniform licensing requirements.

The working group discussed a controversial premium reduction provision that preempts state anti-rebating laws by allowing an insurer to reduce its rates if it can demonstrate that it is more efficient than the average insurer that is contemplated in standard crop insurance rates and subsidies. Davidson advised that no plans have been approved to date. He added that administrative rules would be forthcoming shortly. He urged regulators to review the proposed rules and provide comments to RMA.

Disaster Legislation and Hurricanes in 2004

The Property and Casualty Insurance (C) Committee's Catastrophe Insurance Working Group met in New Orleans. The working group heard a report from Florida related to the four major hurricanes that occurred in 2004. The hurricanes have resulted in 1.5 million claims with insured losses estimated to be more than $20 billion in Florida.

The working group learned that steps taken in Florida after Hurricane Andrew in 1992 have led to positive results. Following Hurricane Andrew, 12 insurers became insolvent. Only one insolvency is expected from the four 2004 hurricanes. Important steps that are credited include:

- Issuing a moratorium to prohibit insurers from non-renewing no more than 10 percent of their business in any one county and 5 percent statewide.
- Creation of the Florida Residential Property and Casualty Joint Underwriting Association as an insurer of last resort (now known as Citizens Property Insurance).
- Creation of the Hurricane Catastrophe Fund to ensure that reinsurance coverage is available to insurers.
- Closely monitoring and encouraging rate adequacy for insurers so that they are able to pay claims from the four storms.
- Implementing tougher building codes so that housing stock is better able to withstand hurricane winds and storm surge.

The working group reviewed pending federal natural disaster legislation and briefly discussed possibilities for creation of a federal or regional natural disaster risk-pooling mechanism. Rick Baum (CA) reported on behalf of Commissioner John Garamendi that the commissioner was supportive of work on natural disaster, risk-pooling mechanisms. The working group observed that recent wildfires in California and the 2004 hurricanes might set the stage for serious consideration on natural disaster legislation in Congress in 2005. The working group also discussed its tax-deferred catastrophe reserve proposal and related legislation. A letter was received from the National Association of Professional Insurance Agents supporting the development of a federal and state coordinated risk-pooling mechanism.

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. The working group heard from FEMA representative Edward Connor regarding the implementation of Section 207 of

Senate Bill 2238. This section requires the director of FEMA to work with states and the insurance industry to establish minimum training and continuing education requirements for insurance producers that sell flood insurance. Connor encouraged states that do not currently include flood insurance provisions in producer licensing tests and continuing education to consider enacting a section of an NCOIL model law that deals with the topic. He also advised that FEMA would be hosting a webcast/teleconference for state insurance regulators on December 8, 2004, to provide an update on flood insurance information and identify resources that states can employ to meet the Section 207 requirements.

Market Conditions

The Property and Casualty Insurance (C) Committee's Market Conditions Working Group discussed a research proposal of the commercial residential insurance market from the NAIC staff. The proposal summarized the working group's desire to study availability and affordability issues relating to owners of commercial multi-family dwellings primarily built for low-income and federally subsidized housing markets. The proposal calls for development of a survey for commercial owners to provide information about the properties they own and their experience in insuring the properties. After hearing further recommendations from members and interested parties, the working group decided to move forward with developing a detailed proposal outlining what baseline data would be needed and what research methodology would be used in such a study. The detailed proposal is expected to be presented to the working group during the NAIC Spring National Meeting in Salt Lake City.

Risk-Retention Groups

The Property and Casualty Insurance (C) Committee's Risk Retention Working Group discussed several agenda items. The working group heard from Larry Cluff (GAO) regarding progress on the GAO study of risk-retention groups. He advised that the report was expected to be finished in February 2005.

The working group listened to a report from Lee Barclay (WA) on vehicle service contracts that are written by risk-retention groups through a contractual liability policy. He described a situation where the insolvency of a risk-retention group led to the development of a Washington law that requires motor vehicle service contracts to be fully insured, rather than insured on an excess basis. He informed the working group of a situation where a service contract provider is able to avoid the application of the Washington law by insuring with a risk-retention group domiciled in another jurisdiction. He believed that the service contract provider is insolvent, yet the risk-retention group that insures it has not reflected the losses that will be forthcoming on its books. He cautioned that consumers and auto dealers would ultimately be left uncompensated once claims are tendered to the risk-retention group.

Director Tim Wagner (NE) reported that he was involved in a hearing related to risk-retention groups and offered to provide a transcript of the hearing to anyone that is interested in it.

Director Wagner led a discussion of how to deal with state accreditation related to regulation of risk-retention groups. The working group decided that it or another working group should revisit the NAIC's *Risk Retention and Purchasing Group Handbook* and update it so that states have a consistent regulatory framework to address the solvency of risk-retention groups.

Terrorism Insurance

The Property and Casualty Insurance (C) Committee's Terrorism Insurance Implementation Working Group met on December 4, 2004, to discuss several issues related to insurance for acts of terrorism. The working group heard reports from NAIC staff related to discussions with the staff of the Terrorism Risk Insurance Program (TRIP) and directly from a representative of TRIP.

The TRIP office is working on several minor clean-up items. Included in the list of items are:

- Development of a protocol whereby TRIP staff can communicate with staff from the Department of Defense and the Department of Justice related to the Treasury Secretary's obligation to determine if an event is an act of terrorism that is covered by the TRIP.
- Development of a process where Insurance Services Office's Property Claims Services can collect information to help the Treasury determine if its $5 million claim threshold has been reached.
- Work on a process to determine which district court would serve as the single source in the event of a covered act of terrorism related to the litigation management part of the Terrorism Risk Insurance Act (TRIA).
- Clarification that requires losses paid by a guaranty association to be treated as losses paid by the insolvent insurer. Further, the receiver is then obligated to distribute a fair allocation of the Treasury payment to the guaranty fund, if called for.

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The working group heard from three insurer trade associations regarding the development of long-term solutions to address the risk of loss from acts of terrorism. The insurer trades pledged to work with regulators to develop a long-term solution.

Title Insurance

The Property and Casualty Insurance (C) Committee's Title Insurance Issues Working Group heard a report concerning title insurers and dealings with captive reinsurers. Surveys have been sent to all title insurers in Colorado. Several other states have also sent out surveys concerning captive reinsurance arrangements and whether or not there is formal risk transfer within these agreements, and whether or not some of these mechanisms attempt to avoid anti-rebating laws.

Uninsured Motorist Coverage

The NAIC is looking at a possible solution to address concerns over the impact of uninsured motorists on insurance consumers. A likely solution has been identified, and details would be forthcoming at future meetings. A vendor had been identified that could deliver a system that would automate the process by linking motor vehicle registration records with a database that matches insurer records. The solution would provide compensation to insurers for the expenses associated with submitting records related to their policyholders' insured status, would generate revenues to participating states, and would provide a modest revenue stream to the NAIC.

Statistical Information (C) Task Force

The Statistical Information (C) Task Force did not meet during the quarterly meeting; however, the task force reported the following significant activities during the quarter:

- The 2002 Homeowners Report is in development. It will be reviewed and considered for adoption by conference call on December 15, 2004. The report is scheduled for release a week later.
- The 2001/2002 Auto Insurance Database Report was adopted and released in September 2004, in a new format. The State Average Auto Premium and Expenditures Report tables have been combined with the Database tables into a single publication that provides a comprehensive set of insurance data, along with state laws and statistics on other factors that contribute to the cost of auto insurance in each state.
- The 2003 Property and Casualty Market Share Report was adopted by the Task Force in August and released in September 2004.
- The 2003 Commercial Lines Competition Database Report is in its final stage of development. Return on net worth data from the 2003 Profitability Report will be added once the Profitability Report is adopted, in early December. The competition report will then be reviewed by task force members and considered for adoption by conference call, with release scheduled a week later.

The Speed to Market (EX) Task Force

The Speed to Market (EX) Task Force met in New Orleans. In addition to hearing reports from its three working groups, the task force heard a report on SERFF activities. The results of the recent SERFF Board of Directors elections were provided. The task force also learned that SERFF v4.5 was released on November 20, 2004. The release has two major components. It includes the implementation of the NAIC Security Model for SERFF EFT and for SERFF Billing, and a re-writing of numerous processes in SERFF to enhance system stability. Further, the number of SERFF filings in November 2004 totaled 17,585. Year-to-date the number of SERFF filings has totaled 132,170. The SERFF Board of Directors is confident that the 140,000 goal for the year would be exceeded.

There has been some controversy regarding its charge to discuss and recommend to the P&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. The task force decided to develop a work plan to complete the task and decided that conference calls would be scheduled in 2005 to move the issue along. Commissioner Terri Vaughan, Ph.D., CPCU, (IA) suggested that a flex-rating system might present the best opportunity to reach a consensus among the NAIC membership. She added that complete deregulation is a nonstarter for most regulators. Lenore Marema, CPCU, (PCI) suggested that the NAIC should forge a partnership with NCOIL on this topic. She stated that the NCOIL has developed a use and file, and a flex rating model law that form a great starting point.

Interstate Compact Bylaws

The chairman of the Speed to Market (EX) Task Force's Interstate Compact Implementation Working Group announced that the members of the Interstate Insurance Product Regulation Commission are having an open meeting via conference call on Monday, December 13, 2004, at 3 p.m. Eastern/ 2 p.m. Central as the Compact requires the Commission to have an annual meeting and prepare a report to the

compact states' governors. The meeting will also focus on efforts for cooperation and collaboration with state legislators on Compact matters.

The working group prepared its strategy for its 2005 charge of drafting proposed rules and operating procedures for consideration by the Interstate Insurance Product Regulation Commission. The working group will initially focus on drafting procedures for the product filing review process, procedures for public access to Commission information and product filing information, and procedures for consumer participation.

Interstate Compact National Standards

The Speed to Market (EX) Task Force's Interstate Compact National Standards Working Group met during an interim meeting in November, and adopted 33 sets of standards: 16 life insurance standards, 15 annuity standards, and standards for individual long-term care insurance and individual disability income insurance. At the NAIC 2004 Winter National Meeting the working group agreed to one final change to the death benefit provisions in the life standards.

The working group discussed the work plan for 2005. The life team and the annuity team will begin developing rider standards and application forms and any other supplemental materials for the products already developed. The disability income team and the long-term care team have begun developing standards for group products. The working group discussed the issues that are arising with the development of group standards and decided to flesh these issues out during an interim meeting. One important consideration is whether state laws defining permissible groups should continue to apply or whether the compact standards should include standards for permissible groups. If state law continues to apply, how will state laws that require individual standards for certain groups be handled? The chairmen will put together a list of questions for states to consider and to submit responses about how they believe these issues should be addressed.

The working group discussed long-term care insurance rates and whether a state could opt out of rates or renewal rates only. The American Council of Life Insurers has taken a position that the association will only support legislation in a state if there is no front-end opt out for long-term care insurance. Further discussion on this issue is needed.

Operational Efficiencies

The Speed to Market (EX) Task Force's Operational Efficiencies Working Group met in New Orleans. Alaska now has joined with the seven other states in the Self-Certification Pilot Program. While data collected to date on the Self-Certification Pilot Program remains not credible to determine overall effectiveness, since the NAIC 2004 Fall National Meeting nearly 50 new pilot filings have been processed. The pilot filings are currently showing an average turnaround time for initial filing review of only two days. A spokesperson for America's Health Insurance Plans suggested that the eight pilot states consider including health insurance filings into the program indicating that many heal insurers would be interested. The pilot program is currently open to only property and casualty form filings.

It was announced that a November 23, 2004, memo has been sent to all commissioners to inform them that the revised Uniform Product Filing matrices for 2005 have now been placed on the NAIC web site. The commissioners were urged to notify their staff of this upgrade to encourage immediate use.

Updates were provided on the following additional Speed to Market tools: Uniform Filing Review Checklists; Uniform Filing Transmittal Documents; Product Filing Requirements Locators; and Filing Metrics Reporting. Discussion turned to how best to involve states that have not yet fully implemented the NAIC Speed to Market tools. Several suggestions were made, which included encouraging states that have been more active with Speed to Market implementation to contact those states that have not been as active in order to encourage and provide support. It was agreed that a system once used to report on the progress of states in implementing the Speed to Market initiatives should be revised and that this subject should be addressed during the 2005 Commissioners' Conference.

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Progress on development of the Product Filing Examiners Handbook was reported. It was explained that the handbook will take some time to complete, but it is anticipated that a first draft will be available for review by the working group during the NAIC 2005 Spring National Meeting.

It was announced that a Speed to Market Seminar is to be held at the Westin O'Hare Hotel in Chicago, Illinois, on January 19, 2005. The NAIC, Property Casualty Insurers Association of America, and InSystems are its seminar sponsors. Also announced was the date for the next NAIC/NIPR E-Regulation Conference: May 22–25, 2005, at the Hyatt Regency Crown Center, Kansas City, Missouri.

The Workers Compensation (C) Task Force

Andrew Sabolic (Florida Division of Workers Compensation) made a presentation on the Florida Construction Policy Tracking Database. The database was developed in response to a Florida law that makes the contractor liable for providing workers compensation benefits if a subcontractor fails to do so. It is a web-based system that tracks coverage and provides electronic notification of changes in coverage status to the contractor. The system receives data from the National Council on Compensation Insurance (NCCI) system that tracks employer coverage. The task force was interested in costs associated with running the system.

The task force received a report from its Employee Leasing Model Laws Working Group. The working group held a conference call on November 19, 2004, where two draft work products were released. The working group is seeking comments on these drafts—Regulation on Workers Compensation coverage for Employee Leasing Arrangements—and a Statement of Principles for Laws and Regulations Applicable when Master Policies are Not Allowed.

The task force adopted an Executive Summary describing the Multi-State Examination of the NCCI. The summary outlined results from the examination and identified items that are deemed to be complete and those that will require ongoing regulatory oversight.

The NAIC/IAIABC Joint Working Group met in New Orleans. The task force adopted several changes to the draft Workers Compensation Large Deductible Study that were recommended by the working group; however, the study itself was not adopted. Deductible reimbursement policies remain an issue in completion of the white paper, but it was reported that progress was made on this issue at the working group meeting. The working group also discussed extraterritorial issues. The working group additionally discussed self-administration of claims by employers and its impact on the workers compensation systems. Also discussed was an issue regarding the effect on the market as a result of claims that are tendered by an injured employee to the employer where the employer fails to report the claim to the insurer. ■

A Practical Guide to Reinsurance Arbitration

by Andrew J. Barile, CPCU

Andrew J. Barile, CPCU, has been in the insurance industry for more than 40 years in the United States. His experience covers all types of insurance coverages, and all forms of insurance entities. Barile has developed all varieties of insurance programs, from development to implementation and execution stages. His articles have been published in numerous insurance trade journals, and he is a frequent lecturer at seminars throughout the United States.

Editor's Note: This article provides some practical advice related to today's reinsurance world. It was written by Andrew J. Barile, CPCU, a member of various CPCU Society interest sections. Barile, with more than 40 years of experience, is a nationally recognized reinsurance industry expert and a frequent contributor to section newsletters; and has been widely quoted in national insurance and business journals. He currently serves as a reinsurance arbitrator and reinsurance expert for companies located throughout the United States. He is the author of *A Practical Guide to Financial Reinsurance; A Practical Guide to Finite Risk Insurance and Reinsurance;* and *Reinsurance—A Practical Guide.*

With uncollectible reinsurance at an all-time high, insurance and reinsurance companies must meet current challenges in dispute resolution. According to a presentation at a recent conference in New York City, buyers of reinsurance have alleged that "reinsurers have stopped paying for valid reinsurance claims."

The United States reinsurance company market has been, as many experienced reinsurance executives predicted, consolidated down to less than 30 reinsurance companies. This has led to more reinsurance disputes, and the need for additional reinsurance arbitration.

Insurance company/reinsurance company professionals must continue to resolve their business disputes via arbitration; however, there is a need for additional neutral and experienced reinsurance arbitrators in order to properly execute the entire reinsurance arbitration process. When someone has performed so many reinsurance arbitrations, can he or she really act as a "neutral?"

We need to expand the education process for reinsurance arbitrations. There are advantages to the arbitration processes used in the United Kingdom and Bermuda, and they could be adopted to improve the United States' reinsurance arbitration system. One example would be the use of neutral arbitrators.

The selection of the Reinsurance Arbitration Panel should be done within proper time frames; delaying tactics, and umpires using three-year time frames, should be unacceptable.

Many reinsurance arbitrations take too long because the parties are too busy doing other reinsurance arbitrations. Controlling costs when arbitrating should be practiced, and more time should be spent qualifying the reinsurance experience of the arbitrators. Someone who understands the practical aspects of the reinsurance industry, and its customs and practices, should make a better reinsurance arbitrator.

We need more input from the experienced arbitrators . . . what are the real issues that are causing these reinsurance disputes? How much has custom and practice in reinsurance changed?

Some questions that might be asked include the following: what might result from taking out "Follow the Fortunes Clause?" How might the reporting of potential reinsurance claims be accelerated? Should reinsurance buying habits be changed? Can ceding insurers get a fair shake if all reinsurance arbitrators worked only for reinsurance companies?

We need to continue to improve the reinsurance arbitration process, as it affects many of the operating insurance companies today, especially their financial solvency. Many of the rating organizations are aware that if the reinsurance arbitration is lost, the carrier will be downgraded. We need to improve the reinsurance arbitration process when solvency of an insurer could be on the line. ■

Your Regulatory & Legislative Section Committee is planning seminars for you to help get your career in gear at the CPCU Society's 61st Annual Meeting and Seminars!

Mark your calendar now and join us October 22-25, 2005, at the Atlanta Marriott Marquis.

Look for more details on these section seminars in upcoming issues of *RLQ*.

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