CPCU SOCIETY
INSURING YOUR SUCCESS
1944–2004
Celebrating the Past, Shaping the Future

Regulatory & Legislative Quarterly

RLQ

Volume 12 Number 2 July 2004

1944—Then and Now

by Eric C. Nordman, CPCU, CIE

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

The year was 1944. It was the year that the CPCU Society was formed when Robert M. Babbitt Jr., CPCU, wrote to the five other recent CPCU conferees encouraging them to form an organization to "foster the aims of the Institute and to aid and encourage others to prepare the Institute's examinations." This led to the formation of the CPCU Society on January 4, 1944. Later that year, from June 15 to 17, the National Association of Insurance Commissioners (NAIC) met at its 75th Annual Meeting at the Edgewater Beach Hotel in Chicago, Illinois. Massachusetts Commissioner and NAIC President Charles F.J. Harrington presided. Answering the roll call were 42 insurance commissioners and three insurance superintendents from Canadian provinces. The CPCU Society convened for its initial meeting on November 13, 1944, when 11 CPCUs gathered in Philadelphia, Pennsylvania and elected Babbitt as its first president.

The purpose of this article is to explore the beginnings of the CPCU Society and contrast its genesis to the issues of the day that were facing the insurance industry and its regulators. I am sure we will find in our journey together that many things are different now than they were then. I think we will also find that many things shared by us all have remained the same.

In his opening remarks at the NAIC meeting, Illinois Insurance Director N.P. Parkinson informed the commissioners that a balanced mixture of work and leisure would be provided. On the leisure side, the commissioners were informed of a baseball game featuring the National League's Chicago Cubs. The committee of companies provided complimentary tickets. While many of today's commissioners still enjoy a good baseball game, often it is on their own dime as such direct industry contributions, in many cases, have been limited by state legislatures.

> *This is a stark contrast to today's modern workplace where a diverse group of insurance regulators of all genders and races serves the needs of the insurance-buying public and the insurance industry.*

Director Parkinson also informed attendees that typing and stenographic services were available. At an NAIC meeting in 2004, a complete copy center and a state-of-the-art computer services network are available for regulators to produce and distribute the millions of pages of materials that go into the production of an NAIC quarterly national meeting. There was also a separate Ladies' Hospitality Committee as all of the commissioners at the time were male. This is a stark contrast to today's modern workplace where a diverse group of insurance regulators of all genders and races serves the needs of the insurance-buying public and the insurance industry.

NAIC Vice President and Minnesota Insurance Commissioner Newell R. Johnson delivered an address that framed the most important issues of the day. In his speech, Commissioner Johnson observed that the NAIC was formed in 1871 because of the landmark case *Paul v Virginia* where the courts held that insurance was not interstate commerce. We all remember studying the case as we prepared for our professional designation. In Part One, we learned that *Paul v Virginia* was the reason that the states were initially charged to regulate the business of insurance. In 1944, that decision had been called into question in a big way. Commissioner Johnson quoted from the September 1870 issue of *The Insurance Times* that prophesied its being

Continued on page 2

What's in this Issue?

1944—Then and Now

Continued from page 1

overturned 74 years earlier. It was in 1944 that the U.S. Supreme Court, in the *United States v Southeastern Underwriters Association*, held that insurance was indeed interstate commerce, and for a time was regulated by the Federal Trade Commission.

Commissioner Johnson, in his remarks, stated:

> Supervision by the states and cooperation among commissioners has existed for all of these years in the public interest. This same interest we must and will keep foremost in our thoughts and deliberations. The recent decision of the Supreme Court does not necessarily mean that state supervision of insurance has been weighed and found wanting. The facts belie and preclude such conclusion.
>
> As insurance commissioner, I am proud of the record of the insurance business over the past 100 years. This record, gentlemen, was accomplished under state supervision. We point with pride to:
>
> - the present financial strength of the insurers;
> - the growth the business has experienced in this country as compared to that of the insurance business in other countries;
> - the part it has played in the development of our industries, commerce and public improvements;
> - the manner in which it has raised our standard of living, and
> - the way in which it has become a part of every man's life.
>
> I believe that on the basis of history and the record, the public interest will be best served by a continuation of progress on the known and tried paths rather than along an unknown way.[1]

Does this all have a familiar ring to it? Today Congress is once again being asked to create a federal regulator. The form that any bill will take is in question; however, the interest from Congress in insurance and insurance regulation has never been higher. Some groups have proposed that a dual regulatory system is ideal and wish to have the same regulatory options as depository institutions to choose between state and federal regulation. Senator Ernest Hollings (D-SC) has introduced a bill that would eliminate state regulation and replace it with a heavy-handed federal regulatory system. Insurance agents, through the Independent Insurance Agents and Brokers of America (IIABA), have suggested that a NARAB-like federal tools approach would be preferable. Representative Mike Oxley (R-OH), chairman of the House Financial Services Committee, has expressed his preference for a regulatory modernization bill that encompasses many of the items suggested by the IIABA. Only time will tell what is to transpire. However, the similarities between what was going on in 1944 and in 2004 are remarkable.

■ ***During the 1944 meeting, a highly controversial topic arose. The NAIC members and the industry were discussing whether it was feasible for property insurers to write casualty business and vice versa.***

Representative Oxley is suggesting that his proposal would focus on speed to market insurance products, including the NAIC's System for Electronic Rate and Form Filing (SERFF) and its interstate insurance compact for life, annuity, long-term care, and disability income products. He also supports the NAIC's operational efficiency improvements that make filing requirements transparent to filers. He supports movements away from rate regulation and toward reliance on competitive rating for property and casualty insurers and development of a national definition of what constitutes a sophisticated commercial insured. He would encourage uniformity in insurer licensing and moving from reciprocity to true uniformity in producer licensing. Representative Oxley expressed support for the market conduct model law that was recently adopted by the National Conference of Insurance Legislators. While affirming that a federal insurance regulator would not be created, Representative Oxley suggests that a new federal-state advisory council would be necessary to coordinate discussion over tax policy and uniformity issues.

During its 1944 meeting, the NAIC members discussed the status of the NAIC's newly adopted Securities Valuation Office (SVO) and concluded that the SVO allowed insurance regulators to better evaluate insurer holdings. On the life insurance side, the NAIC members received an update on the adoption of new mortality tables and the introduction of a new concept called nonforfeiture benefits. The regulators were interested in workers compensation rates (although they were called workmen's compensation at the time) and held a two-day interim meeting at the New York offices of the National Council on Compensation Insurance. That meeting produced a controversial paper on the topic of general expense loadings. An impending crisis for workers compensation was noted as plants were converting from wartime to peacetime activities and unreported claims were coming to light. Malingering was discussed and some of the increased claims activity was attributed to it. Retrospective rating plans had been recently introduced and were receiving some attention from the regulators. Today the controversy over expense loadings has been replaced by controversies over what to charge businesses for covering acts of terrorism. We are in the midst of yet another workers compensation crisis in many states and concern over retrospective rating has been supplanted by concern over the application of large deductibles.

During the 1944 meeting, a highly controversial topic arose. The NAIC members and the industry were discussing whether it was feasible for property insurers to write casualty business and vice versa. President Harrington stated:

> A number of Hartford companies prevailed upon the Minnesota legislature to amend the laws of that state to permit them to continue to be licensed although possessing broader charter powers than those granted to Minnesota companies. We now find these companies subscribing to a criticism of the work of the Multiple Line Committee, because they claim its ultimate objective is the authorization of multiple line charter powers for all companies. We should consider whether or not such an attitude is in the pubic interest. I doubt that it should be encouraged by insurance commissioners.[2]

Eventually this issue was resolved, and enlightened minds thought that it might be acceptable to insure both property and casualty risks in the same policy. This monumental decision led to the introduction of the homeowners contract a few short years later.

The NAIC convened its mid-winter meeting on December 4, 1944. It ran until December 7 and continued the important discussion concerning federal regulation. A stark difference in methods of communication was observed when the proceedings noted “the interest shown by Senators and Congressmen, as indicated by phone calls, telegrams, and letters, virtually made it imperative that the result of our deliberations be transmitted to them immediately.[3]” This is a stark contrast to today’s instant communication world where electronic messages reach people instantly using wireless communication devices. President Newell R. Johnson (Minnesota) reported that he led a delegation to Washington, DC to meet with members of Congress.

As we all know from our CPCU studies, the insurance industry and the state insurance regulators were eventually successful in convincing Congress that a federal insurance regulator was unnecessary. Out of the chaos caused by the *Southeastern Underwriters* case arose the framework for insurance regulation that exists today. The passage, on March 9, 1945, of the McCarran-Ferguson Act put an end to the debate and allowed this newly defined interstate commerce to flow once again. The act declared that:

> The continued regulation and taxation by the several states of the business of insurance is in the public interest, and that silence on the part of Congress shall not be construed to impose any barrier to the regulation or taxation of the business by the several states.[4]

The McCarran-Ferguson Act was intended to preserve state regulation of the business of insurance only to the extent that Congress chose not to enter the field. Its basic legislative purpose is to allow states to regulate and tax the business of insurance free from inadvertent preemption by federal law. A secondary purpose was to provide insurers with a partial exemption from federal antitrust laws. The partial exemption allows insurers to prepare and file rating schedules jointly or collectively, but only so long as they are regulated by state law and do not amount to boycott, coercion, or intimidation. This partial exemption allowed the formation of what was then called rating organizations that filed rates on behalf of member insurers and in many cases virtually mandated adherence to the filed rates. Today, rating organizations are generally known as advisory organizations and they file loss costs rather than final rates in most cases. Deviation from the filed loss costs is widely accepted or even encouraged as states move toward greater reliance on competition to replace traditional, rate regulation.

Keeping up with current events is a challenge that is readily accepted by CPCUs throughout the world. While in the United States, there will probably always be debate about what level of regulation is appropriate and how best to accomplish the regulatory purpose, 2004, much like 1944, appears to be a landmark year where the debate is more intense than usual. While the end is in sight, we have only just begun. Both regulators and the regulated need to remember that they have the same end-goal in mind. The common goal of insurers and regulators is that insurers have sufficient funds to make good on the promises they have made to the public and that they treat policyholders and claimants right. It is consistent with the CPCU Society’s mission, “The CPCU Society is dedicated to meeting the career development needs of a diverse membership of professionals who have earned the Chartered Property Casualty Underwriter (CPCU) designation so that they may serve others in a competent and ethical manner.” Those values have not changed since the CPCU Society was formed in 1944. ■

Endnotes

1. Proceedings of the National Association of Insurance Commissioners; Seventy-Fifth Session 1944, page 96.
2. Ibid, page 107.
3. Proceedings of the National Association of Insurance Commissioners; Seventy-Sixth Session 1945, page 11.
4. U.S.C.A. 15 § 1011.

The Changing Landscape of Insurance Company Regulatory Compliance

by Penny Kilberry, CPCU, ACP, AIS

Penny Kilberry, CPCU, ACP, AIS, is assistant vice president, regulatory compliance, of Monitor Liability Managers, Inc. in Rolling Meadows, Illinois. She serves on AICPCU's Advisory Committee for Insurance Regulation. Kilberry is a member of the national Board of Directors for the Association of Insurance Compliance Professionals (AICP), and serves as vice president of the AICP's Great Lakes Chapter. She holds the designations of CPCU, AIS, and Associate Compliance Professional (ACP). She is a graduate of Northeastern Illinois University.

At the start of the 1990s, the primary focus of the insurance regulatory compliance function, for most companies, was product filings. For many of these companies, eager to introduce new and revised products in target states, the compliance function was considered to be an organizational bottleneck, where newly developed products sat in limbo awaiting "filing and approval," before they could be offered in the marketplace. This perception was uncomfortably close to reality, as the approval process was often lengthy, unpredictable, and inconsistent between states.

Today, with the success of the NAIC's ongoing speed to market initiatives, including the development of filing checklists and the System for Electronic Rate and Form Filings (SERFF), the product filing process has become more efficient. While filings process improvement continues to be a work in progress, these initiatives have done much to alleviate the administrative burden and lengthy process that characterized the product approval process of the previous decade.

Although product filings continue to be an integral part of the compliance function, increased efficiencies of the process have made way for compliance departments to better respond to ever-changing regulatory demands with respect to other areas of company operations. As the emphasis of the compliance function has shifted in response to the changing regulatory environment, its importance to the successful operations of the insurance company has grown, and, due to the widely publicized costs of noncompliance, the top management of most companies has become increasingly aware of the impact of compliance operations on the bottom line.

Today's compliance function in most companies is broad in scope, and may incorporate some or all of the following functions.

Internal Audits

Although the audit function varies among companies, those that utilize this process most efficiently often model audits after market conduct exams, and structure them accordingly. Audits may be targeted toward a specific line of coverage, a geographical territory, a certain function (e.g., underwriting or claims), or may be comprehensive and broad in scope.

An underwriting audit, for example, involves the objective scrutiny of the policy underwriting process. The auditor typically utilizes a checklist to review selected policy files. Items evaluated include forms usage. The auditor will determine if all forms used are approved for use in the particular state, and that any state-mandated forms are attached to the policy. The auditor will also check policy rating, to ensure that the process, including any automated rating, reflects what was approved by the state. In addition, the auditor reviews any schedule ratings to ensure that any credits or debits applied are within the state-allowable guidelines, and are properly documented. Compliance with state-mandated notice requirements is also checked. An additional aspect to the audit is that it often serves as a review of the company's internal policy processing standards.

No matter what specific format a company uses, the ultimate goal of the audit function is to measure company compliance with regulatory requirements, to identify areas where training may be needed, to recommend any necessary corrective action, and, ultimately, to lessen the company's exposure to market conduct sanctions and fines.

Market Conduct Coordination

When an insurer is subject to a state market conduct examination, a representative from the compliance area usually coordinates the exam on behalf of the company. The coordinator has the unique position of acting as liaison between the insurer and the state insurance department, and helps to set the tone of the exam process. A cooperative attitude, and a willingness to respond to the examiner's requests completely and on a timely basis, conveys the insurer's willingness to work with the insurance department in addressing any questions or concerns. The role of the coordinator is an important component of the overall success of the exam process.

Complaint Handling

Unresolved and poorly handled complaints can impact the company's reputation in the marketplace and trigger market conduct exams. In most companies, the Compliance Department is the central point for all complaint handling. Typically, complaints are recorded into a central log, which can be used to identify and track any trends in activities resulting in complaints. The compliance unit forwards copies of the complaint to the units/persons involved in the allegations, determines the timeline for response, and composes or reviews the response before it is forwarded to the insurance department.

Legal Analysis

An important area of the compliance function is legal research and analysis. Whether in response to product filings concerns, or to ascertain state requirements for policy activity, the ability to access and interpret current state legislation or regulations is a critical compliance function. Key to this process is the ability to track pending legislative initiatives that are relevant to the company.

Communicating Compliance Issues to Noncompliance Staff

Clearly, compliance with insurance laws and regulations must be an organization-wide effort. An important aspect of the compliance function is to provide relevant information to noncompliance staff, and to ensure that these resources are kept current and communicated on an organization-wide basis.

The types of resources utilized for this purpose vary, but generally include a database of approved products, specific details on approved policy forms and rating rules, and state rules for policyholder notification. Some insurers utilize outside resources for this purpose, others develop them internally, and still others use a combination. The compliance area develops, selects, and monitors information resources, and helps to ensure that noncompliance staff knows how to access them.

In addition, many insurers now include compliance training as part of the general employee orientation and training process. In addition to helping employees to utilize regulatory resources, mandatory training helps to communicate and promote corporate commitment to regulatory compliance.

Federal Requirements

Federal law changes directly impact the compliance function. In the past decade, this simply was not an issue. However, the compliance professional is now charged with interpreting and implementing procedures to comply with directives relating to banking and insurance, terrorism, and privacy. The role of the federal government in insurance continues to evolve, as evidenced by the current development of the Oxley-Baker proposal, which would create legislation to develop a state-federal partnership to increase nationwide uniformity in insurance regulation. The future of the federal government's role in insurance is uncertain, but ensuring the insurer's adherence to federal requirements is another function of the compliance area.

Product Submission and Approval

Last but not least, although the filing process has improved dramatically in the past decade, its importance to overall profitability of the insurer cannot be stressed enough. Simply, if a product is not approved for sale in a state, the insurer's income will be negatively impacted. The role of the compliance area in the successful filing process is, ideally, one that reflects a proactive approach to the product submission process. All new and revised products should be carefully scrutinized before submission to the state insurance departments, to ensure all known state requirements have been taken into account.

Negotiation will always be a component of the product submission process, but an effective compliance function, one which stresses front-end analysis, will have a positive impact on the approval process, and will promote product speed to market.

A Changing Environment

The Compliance Department today is charged with maneuvering through a changing regulatory landscape, and shifting direction accordingly. The successful compliance professional is one who is able to track and communicate relevant legislative and regulatory initiatives on a company-wide basis. The person in this role acts as the company's liaison with regulatory bodies, and must possess technical insurance knowledge, analytical ability, and diplomatic communication skills.

Above all, the effective compliance professional is a change agent, whose primary responsibility is to tailor the company's policies and procedures to evolving regulatory requirements, and to help ensure that the company projects a positive image in the insurance regulatory community. ■

TRIA—Extend or Sunset: That Is the Question

by Eric C. Nordman, CPCU, CIE

Congress has already taken an interest in a topic that is near and dear to insurers' hearts—namely the possible extension of the Terrorism Risk Insurance Act of 2002 (TRIA). Late last year, the National Association of Insurance Commissioner's Terrorism Insurance Implementation Working Group began to hear from industry attendees that TRIA and the Terrorism Risk Insurance Program (TRIP) needed to be extended.

■ *Insurers face uncertainty about TRIA's sunset since they will be dealing with their customers without knowledge of what Congress might do regarding an extension of TRIA.*

The call to arms reached a fever pitch at the NAIC's 2004 Spring Quarterly Meeting. The working group discussed a problem regarding the deadlines contained in TRIA and how they do not fit very well with the business cycle of insurers. For example, a commercial policy issued in late 2004 with an effective date of January 2, 2005 or later will contain coverage for acts of terrorism that is partially backstopped and partially without a federal backstop in place. Insurers face uncertainty about TRIA's sunset since they will be dealing with their customers without knowledge of what Congress might do regarding an extension of TRIA. Another uncertainty is whether the Treasury will renew the "make available" requirement in TRIA for 2005. An answer on this requirement is expected in September 2004. Action by Congress on the extension of TRIA is not expected until it receives the Treasury report on TRIA's impact and the ability of the insurance industry to operate without a federal backstop. This report is due in June 2005. From an insurers perspective, this is about eight months too late to not cause some disruption.

The obvious answer is for Congress to grant a one-year or longer extension of TRIA so that it is able to receive and digest the information provided by the Treasury in its report to Congress. However, what appears to be obvious to all on the surface is not always as simple to implement as it might seem. When the working group discussed a simple extension, it was able to reach a quick consensus that something must be done. There was not universal agreement about what exactly the solution should be. There were those that thought improvements should be made to TRIA; however, no specifics were provided. Representatives of the group life insurance industry hoped to gain support for inclusion of group life in the TRIP. Others thought a simple one-year extension would work. Still others thought that extension of the coverage period without extending the act was acceptable.

■ *. . . the NAIC urged action by the Congress this year on a federal solution to ensure continued marketplace stability when TRIA expires at the end of 2005.*

The NAIC's working group agreed to send a letter to influential members of Congress suggesting that there was a problem and that a timely solution was warranted. They also agreed to draft a resolution evaluating various options for fixing the timing problem. Letters were sent on April 6, 2004, to Representative Mike Oxley (R-OH) and Senator Richard Shelby (R-AL). In the letters, the NAIC urged action by the Congress this year on a federal solution to ensure continued marketplace stability when TRIA expires at the end of 2005. The working group is also collecting comments and suggestions as it develops its resolution on potential solutions regarding the extension.

The Treasury published a request for comments on TRIA's "make available" requirement. The publication appeared in the *Federal Register* on May 5, 2004, (Volume 69, Number 87) and solicited comments by June 4, 2004. Specifically, the Treasury is interested in people's opinions regarding whether the "make available" requirement should apply during the third year of the TRIP. TRIA leaves to the Secretary of the Treasury the decision on whether insurers should be mandated to offer coverage for acts of terrorism on the same terms and conditions that applied during the first two years of the program. The NAIC working group plans to hold a conference call to discuss this issue and review a draft letter to the Treasury.

In another development, insurance regulators began receiving filings from Insurance Services Office, Inc.—the nation's largest insurance advisory organization during the week of May 5, 2004. These commercial lines filings covering property and general liability present contingent policy provisions related to acts of terrorism that will only be activated if TRIA sunsets at its statutory expiration date of December 31, 2005, or is continued with certain other changes. Comparable ISO filings for other lines are expected over the next several weeks. ISO's filings are designed to provide insurers with several options to manage the terrorism risk given the possibility that Congress will not act or will not act in a timely manner. Regulators have received similar filings from individual insurers.

Stay tuned. It looks like 2004 is another year of uncertainty. Will Congress extend TRIA to keep the federal government involved in providing a backstop for acts of terrorism? Will the Treasury extend the "make available" requirement for the third year of the TRIP? Only time will tell. We will keep you informed through the newsletter and the section web site. ■

Regulators and Insurers Discuss Class-Action Litigation

by Eric C. Nordman, CPCU, CIE

On March 13, 2004, the NAIC's Class Action Insurance Litigation (C) Working Group and the CPCU Society's Regulatory & Legislative Section co-hosted an educational event attended by approximately 175 attendees. Held in New York in conjunction with the NAIC's Quarterly National Meeting, Commissioner Larry Mirel (DC) served as keynote speaker for the session. In his keynote address he described the major concern of insurance regulators. He believes that under certain circumstances, class-action lawsuits have unreasonably encroached on regulatory functions that traditionally have been exercised by insurance commissioners.

Commissioner Mirel mentioned *Hill v State Farm* as a case that is particularly troublesome. In *Hill v State Farm*, the issue is distribution of the surplus maintained by State Farm to its mutual policyholders. He opined that solvency regulation has always been a fundamental regulatory function. He is deeply troubled that a jury of 12 California residents is, in *Hill v State Farm*, being asked to substitute its judgment for that of the insurance regulators.

Commissioner Mirel commented on a variety of other cases, including modal premium cases and *Avery v State Farm*. In *Avery*, the issue is the use of Original Equipment Manufacturer (OEM) parts. In the suit, settled in favor of the plaintiffs, State Farm agreed to discontinue use of non-OEM parts. In this case, the Illinois decision was applied throughout the country and tends to increase the cost of auto insurance throughout the nation. Thus, the nation's insurance regulators and state legislatures were stripped of the public policy-making role by the Illinois court.

Commissioner Mirel commented on pending federal legislation that would remove many class actions to federal court. He also described a recently enacted Texas law that requires courts to consider a claim that a particular issue is a regulatory matter and support its findings in its written decision.

Commissioner Mirel encouraged attendees to participate in the process of developing guidance for courts that helps them decide when a case is ripe for class action and when a case should be decided by the insurance regulator. State legislatures make public policy decisions and hire insurance regulators to implement the public policy decisions that are expressed in law. He believed that it is critical that the roles be clearly defined so that sound public policy is implemented.

Panelists included Steve McManus (State Farm), Donald Beatty (VA) and Jackson Williams (Public Citizen's Congress Watch). McManus discussed forum shopping that has been rampant in certain jurisdictions. He described a situation in a rural jurisdiction know as Madison County, Illinois. This rural, lightly populated county has more class actions filed than any other county in the country except for Los Angeles County, California, and Cook County, Illinois.

■ *. . . many of the class-action litigations related to insurance relate to breach of contract or interpretation of policy language.*

McManus described a situation that he characterized as extortion—namely leverage to settle. When a court certifies a class action, there is tremendous pressure on the insurer to settle or face astronomical potential costs. He was also very concerned with the small coupon settlements for plaintiffs while attorneys receive millions of dollars in legal fees. He believed that lawyers seeking larger fees often compromised interests of consumers. He concluded that regulation through litigation has undermined legislative and regulatory policy.

Beatty observed that many of the class action litigations related to insurance relate to breach of contract or interpretation of policy language. He noted that regulators are not supposed to handle breach of contract or interpretation of policy language. He believed that when a state regulator grants approval of policy language, a court is not bound to the decision of the regulator. He also suggested that regulators could learn from court decisions and might decide that changes in policy language are needed because of decisions that courts have made.

Williams noted that companies do not mind sending coupons; however, they would prefer not to send checks to customers. He observed that some cases clearly belong in the courts. He included fraud, innovative techniques employed by insurers, and clear misconduct that has not been addressed by the regulators. He believed that when a commissioner has the appropriate authority and has ruled on the issue, some deference should be given to the regulator. He agreed with Beatty that issues related to breach of contract and interpretations of policy language were appropriate for the courts. He believed that judicial selection processes should be evaluated to improve the process. He advocated for a merit system for judicial appointees.

The panel discussed Senate Bill 274 and had mixed feelings about its likelihood of passage. The panel fielded questions from the audience and engaged in a lively discussion related to the issues raised by the panelists. ■

IRES Market Regulation School Session on Market Analysis

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

Damian V. Sepanik, J.D., CPCU, is an attorney in private practice concentrating on insurance regulatory matters. During his tenure as an insurance company executive, he served as general counsel for several business units and headed an internal coverage litigation law firm. Sepanik also serves as co-chairman of the CPCU Society's Regulatory & Legislative Section.

Editor's Note: The Insurance Regulatory Examiners Society (IRES) Foundation recently held its annual market regulation school. This popular school brings together the best and the brightest in the market regulation arena arming regulatory professionals with the cutting-edge information that allows them to help their companies remain compliant. What follows is a summary of a session held on the hottest topic in market regulation today, market analysis.

Any questions regarding this article or market analysis in general may be directed to Damian V. Sepanik, J.D., CPCU, at dsepanik@direcway.com. Sepanik can also be contacted by telephone at (847) 277-1092.

Let me take you back for a moment to England in the 1500s. Even then, England is old and small and the local folks started running out of places to bury people. So they begin to dig up coffins and take the bones to a "bone-house" and reuse the grave. When re-opening these coffins, a number of coffins were found to have scratch marks on the inside and they realized that they had been burying people alive. So they began to tie a string on the wrist of the corpse, lead it through the coffin and up through the ground, and tie it to a bell. Someone would sit out in the graveyard all night (the graveyard shift) to listen for the bell; thus, someone could be "saved by the bell" or was considered a "dead ringer."

Back in the old days of market conduct, a combination of market conditions and company management could encourage some companies to treat consumers poorly and not comply with laws and regulations. Regulators would catch them and punish them and hope for better performance. If no improvement occurred they would revoke their license.

Then regulators started conducting examinations of all companies, good and bad, on a regular basis. Unfortunately, it would often take years to complete the exam, often resulting in findings that occurred many years prior. The damage had already been done, much like the scratches on the inside of the coffins.

Well, things are changing in market conduct. Regulators are using sophisticated techniques to identify which coffins contain the action. The idea is to target the companies that need the regulatory attention and to avoid devoting resources to those that don't. In theory, companies that are operating properly are not burdened with the distraction and cost of unneeded exams.

Is your company ringing the bell? You may be surprised by the answer. Today we are going to hear from a panel of experts on this subject. The Market Analysis Working Group is up and running and every compliance professional needs to know about the far-reaching effects of this group.

We assembled a panel of regulators that are at the forefront of this emerging issue. The following are overviews of the panelists' presentations.

Timothy B. Mullen

Director, Market Conduct Regulation Division
NAIC

The move toward market regulatory reforms was initiated several years ago when the NAIC issued the Statement of Intent. The report on the status of state insurance regulation released by the Government Accounting Office (the "GAO Report") kicked it into high gear. The findings of the GAO Report coincide with the current emphasis of the NAIC's market regulatory reforms of market analysis, uniform examination procedures, and interstate collaboration.

A *Market Analysis Handbook* has been developed by the NAIC and follows closely the approach taken in financial analysis. The NAIC tracks data from a number of reports. Through improved coding procedures, the NAIC is now producing better quality data to be used in market analysis.

Every state is required to appoint a market analysis coordinator. The main things the market analysis approach focuses on are premium volume changes, reserve changes, and claim cost changes. This analysis is very much moving away from just an industry-wide perspective. It is becoming much more individual-company specific.

Mullen cautioned the audience not to expect any lessening of regulatory enforcement as a result of the use of market analysis. This approach provides regulators with a better range of responses to perceived problems and allows for a more timely and specific response. This idea is not a passing interest. The job description of four NAIC employees is to do market analysis full time.

Dennis C. Shoop

Director, Bureau of Enforcement
Pennsylvania Insurance Department

Shoop focused on the NAIC Market Conduct Annual Statement ("Annual Statement") and its relationship with market analysis. The Annual Statement started when the NAIC observed the quality market data being collected by the Illinois and Ohio Insurance Departments. Since that time, The NAIC "D" Committee (Market Regulation and Consumer Affairs) has in fact been spending more time discussing market analysis issues than market conduct issues.

Nine states participated in an initial pilot program. There was a life data call distributed to companies for the time period of January to June 2002, and a property and casualty data call distributed to companies for the time period of January to June 2003. Pennsylvania received 439 responses to the life call and 476 responses to the property and casualty call.

The regulators were very pleased with the results of the pilot. For the first time they had access to market information from all insurers, both life and property and casualty. Prior to this, basic information like number of cancellations, number of consumer complaints, etc. was not readily available all in one place.

The market analysis system is designed with integrity checks to ensure data quality. These edits resulted in inquiries going out to 70 percent of respondents for corrected data.

Nine states have agreed to working together and sharing information on a uniform basis. They now know what industry norms are and what the baseline for review is.

Shoop recognized that the industry has expressed concerns about confidentiality of data and of the potential for class-action litigators gaining access to the data. He assured the audience that the NAIC is very sensitive to these issues and is working hard to protect the confidentiality in the data. However, some states have less leeway than others due to statutory provisions such as sunshine laws.

Once the data from the Annual Statement is accumulated and formatted, it is shared with the Market Analysis Working Group (MAWG) at the NAIC. This allows regulators from multiple states to discuss possible trends and corrective action. The value of this is that regulators are able to access all insurers in their state to make decisions and to identify potential problems no matter what size they are.

Bruce Ramge

Chief of Market Regulation
Nebraska Department of Insurance

Ramge discussed what regulators really look for when going through the market analysis process. He said that at the Market Analysis Working Group (MAWG), level exam tracking reports are studied carefully. If a number of exams are scheduled for the same insurer at the same time, a conference call is conducted to coordinate the activities.

If MAWG notices suspicious activity, it has the ability to ask the company to appear before it at an NAIC National Meeting to discuss the issue. Oftentimes MAWG will at that time review prior examination reports for the company. A MAWG proceeding does not always result in a market conduct examination. If an examination is warranted, MAWG could appoint a lead state to conduct the exam. MAWG would also consider legal opinions presented by an insurer attending a MAWG proceeding.

Ramge noted that many things can trigger a MAWG analysis. Major complaints and historically bad compliance are at the top of the list. Certain hot issues also trigger closer scrutiny. Examples Ramge cited are senior (elder) issues, complaint ratios, sudden changes or trends in a company, certain vendor and TPA arrangements that generate complaints or concerns, managed care issues, mandated benefits and producer issues, and company responsiveness. Examples cited for company responsiveness include evasiveness when responding to regulators and internal procedures that are out of sync with industry practices.

Ramge said that as a result of market analysis, it is unclear whether states will continue to conduct comprehensive exams in the future. On the other hand, companies should be required to prove that issues raised by a particular state have been resolved universally.

Susan T. Stead

Assistant Director of the Office of Investigative and Licensing Services
Ohio Department of Insurance

Stead provided advice to the industry regarding market analysis. She said that data calls are now extremely important. Care should be taken to answer these calls on time and accurately. Companies must have procedures, follow them, show prompt action on complaints, and have internal standards that trigger corrective action.

Stead encouraged companies to get information about the jurisdictions your company does business in. Know what is important to that regulator. Sign up for news releases and other information via state insurance department web sites.

Companies should visit their regulators regularly, even when you don't have problems in that state. Let the regulators know about what is going on in your company. That way, when they see suspicious information it will allow them to place it in the appropriate context.

Have a competent person responsible for data calls. This should be a person who is not only knowledgeable about the business but really understands IT and who in IT to get involved.

Understand what data regulators are looking for. Eyeball your responses. Do they look accurate? Do they look responsive? Are they likely to trigger a question? If so, be proactive.

Finally, Stead advised that regulators have heard many excuses for bad data. "We are a big company, small company, I'm not the right person, our systems don't talk to each other." Excuses don't help. Fix the problem and be responsive. ■

The Terrorism Risk Insurance Act of 2002: Let It Sunset or Extend It? Additional Thoughts

by Eric C. Nordman, CPCU, CIE

Members of the National Association of Insurance Commissioners (NAIC) have offered testimony to Congress regarding the Terrorism Risk Insurance Act of 2002 (TRIA) on two occasions. In addition, correspondence has been delivered to key members of Congress on a possible extension of TRIA and extension of TRIA's "make available" requirement into 2005. Insurance regulators generally believe that there is a need for continued federal financial backing for the private insurers in order to prevent negative economic consequences and market instability.

On May 18, 2004, in a hearing before the Senate Committee on Banking, Housing, and Urban Affairs, the NAIC recommended the extension of both the "make available" requirements in the Terrorism Risk Insurance Act, and the extension of coverage under the Terrorism Risk Insurance Program (TRIP). The hearing also included testimony from representatives of the insurance industry, the General Accounting Office, and the Treasury Department.

"We believe that the federal backstop has provided a measure of comfort to the industry and has encouraged insurers to offer terrorism coverage," said Donna Lee Williams, Delaware Insurance Commissioner and chairman of the NAIC's Terrorism Insurance Implementation Working Group. "The backstop is essential. Insurers will be reluctant to accept complete risk transfers from American business until insurers become comfortable that government efforts are adequate to protect citizens from terrorist attacks."

■ *We believe that the federal backstop has provided a measure of comfort to the industry and has encouraged insurers to offer terrorism coverage.*

Williams added that state regulators are concerned significant market disruptions will develop before TRIA's expiration because some terrorism risks are largely uninsurable without a financial backstop. This, she said, is due in large part to the deadlines contained in TRIA, which currently do not match the business cycle for insurance renewals.

"There are two primary ways that Congress can help restore the market for terrorism insurance," said Williams. "One is to encourage the Secretary of the Treasury to impose the 'make available' provision for the third year of TRIP. The second is for Congress to act this year to extend the expiration date in TRIA to a future date that is consistent with the cycle for renewals."

Williams suggested in her written testimony that there are alternatives to extending the expiration date of TRIA. One such alternative is to extend the coverage period without extending the actual effective date in the law. While retaining the termination date of December 31, 2005, language could be added stating that the program would continue to provide compensation for insured losses resulting from acts of terrorism for policies or contracts issued or renewed before December 31, 2005, until the policy expiration date or one year from the inception date, whichever is less. "The NAIC stands ready to assist Congress in developing an appropriate method for continuing the federal terrorism reinsurance backstop," she said.

On April 28, 2004, New York Superintendent Gregory V. Serio testified before the House Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises and the Subcommittee on Oversight and Investigations. "Our nation is still in the midst of searching for appropriate and permanent solutions to the challenges brought about by recent events and rapidly changing dynamics of political and economic risk," he advised.

Superintendent Serio stated, "Just as President Bush is advocating for renewal of the USA PATRIOT Act to protect the nation from physical threats, our responsibility as legislators and regulators of the financial services sectors is to ensure a timely resolution to the debate surrounding TRIA in order to stabilize and protect our financial marketplace." He described the problems facing insurers and businesses related to what has become known as the "hard ending" contained in TRIA. Some of the deadlines in TRIA do not coincide with the business cycle of insurers. For example, a commercial policy issued in late 2004 with an effective date of January 2, 2005 or later will contain coverage for acts of terrorism that is partially backstopped and partially without a federal backstop in place. Insurers face uncertainty about TRIA's sunset since they will be dealing with their customers without knowledge of what Congress might do regarding an extension of TRIA. Another uncertainty is whether the Treasury will renew the

“make available” requirement in TRIA for 2005. An answer on this requirement is expected in September 2004. Action by Congress is not expected until it receives the Treasury report on the TRIA impact and the ability of the insurance industry to operate without a federal backstop. This report is due June 30, 2005. From an insurer’s perspective, this is about eight months too late to not cause some disruption.

In pledging his support and offering his assistance to the subcommittees, Superintendent Serio closed by saying, “I am hopeful that all parties involved will be mindful of the ultimate goal of this exercise—increasing the availability and affordability of terrorism coverage throughout the nation.”

In a related activity, on April 6, 2004, key members of the NAIC sent a letter to Congressional leaders urging that the federal government move to ensure insurance marketplace stability and economic security as the expiration of the TRIA approaches.

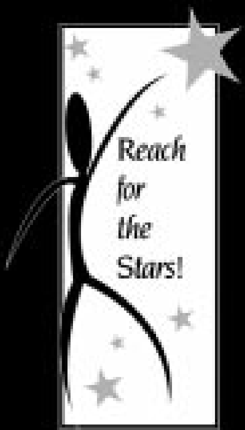
The letter, addressed to Rep. Michael Oxley, chairman of the House Committee on Financial Services, and to Sen. Richard Baker, chairman of the Senate Committee on Banking, Housing, and Urban Affairs, indicated state regulators’ concern that “significant market disruption may develop before TRIA’s expiration” at the end of 2005. The commercial insurance business cycle will require insurers and policyholders to make decisions this year with regard to coverage into 2006, thus bringing a need to contemplate no federal backstop for potential losses beyond 2005.

■ ***This is the same situation we encountered in the aftermath of September 11, 2001, and which in large part prompted TRIA’s enactment.***

The unknown status of any federal backstop will affect business decisions well before the Treasury Department’s June 2005 report to Congress. This brings the likelihood of the widespread introduction of conditional exclusions for terrorism coverage, which could cause market disruptions and damage to economic growth or overall business confidence.

“This is the same situation we encountered in the aftermath of September 11, 2001, and which in large part prompted TRIA’s enactment,” states the letter, which is signed by four NAIC members: South Carolina Commissioner Ernst Csiszar, NAIC President; Superintendent Serio, chairman of the NAIC’s Government Affairs Task Force; Texas Commissioner José Montemayor, chairman of the NAIC’s Property and Casualty Insurance Committee; and Commissioner Williams.

The letter concludes by urging “Congressional action this year to avoid market disruptions that will occur in the absence of a federal backstop program,” and highlighting the NAIC’s willingness to assist with a solution. The NAIC noted that regulators want to ensure that the Treasury Department has the time it needs to study the issue and make recommendations, while still maintaining stability in the market. ■



Register Today for the CPCU Society's 60th Annual Meeting and Seminars

Reach for the stars and attend the 60th Annual Meeting and Seminars October 23-26, 2004, in Los Angeles, CA. Register online and get complete meeting details, including seminar descriptions such as the one below, at **www.cpcusociety.org**.

Where Have All the Companies Gone?

Sunday, October 24, 9 - 11 a.m.

What You Will Learn

What does the future hold for the insurance industry? Attend this seminar for a broad perspective on various insurance topics, such as macroeconomics, regulation, policyholders' surplus problems, bad management, asbestos, pollution, and all other class-action litigation. An examination of the insurance industry's current problems and shortcomings, such as these, is the best way to understand how you can succeed. In addition to this, a case study of select companies will be used to provide a current view of the industry and projections as to where the industry is headed.

Developed by the Excess/Surplus/Specialty Lines and Regulatory & Legislative Sections.

Presenters

Andrew J. Barile, CPCU
Andrew Barile Consulting, Inc.

Eric C. Nordman, CPCU, CIE
National Association of Insurance Commissioners

Gregg Rentko, CPCU
ACE Insurance

Nelson Rivera, CPCU, CPA
A.M. Best Company

Damian V. Sepanik, J.D., CPCU
Law Offices of Damian V. Sepanik, LLC

Register today at www.cpcusociety.org!

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

***RLQ* Editor**
Eric C. Nordman, CPCU, CIE
National Association of Insurance Commissioners
Phone: (816) 783-8005
e-Mail: enordman@naic.org

Regulatory & Legislative Section Co-Chairman
Eric C. Nordman, CPCU, CIE
National Association of Insurance Commissioners
Phone: (816) 783-8005
e-Mail: enordman@naic.org

Regulatory & Legislative Section Co-Chairman
Damian V. Sepanik, J.D., CPCU
Regulatory Attorney
Phone: (847) 277-1092
e-Mail: dsepanik@aol.com

Sections Manager
John Kelly, CPCU
CPCU Society

Managing Editor
Michele A. Leps, AIT
CPCU Society

Production Editor/Design
Joan Satchell
CPCU Society

CPCU Society
720 Providence Road
PO Box 3009
Malvern, PA 19355-0709
(800) 932-2728
www.cpcusociety.org

CPCU SOCIETY
INSURING YOUR SUCCESS
Celebrating the Past, Shaping the Future

Regulatory & Legislative Quarterly RLQ

Volume 12 Number 2 July 2004

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