Regulatory & Legislative Interest Group

Compliance Matters

Volume 17 • Number 1 • February 2010

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Message from the Chair

by Joseph F. Bieniek, CPCU, AIE, CCP, CIC, ARC, MCM, AIS, AU

Joseph F. Bieniek, CPCU, AIE, CCP, CIC, ARC, MCM, AIS, AU, is the senior regulatory services advisor for the National Association of Insurance Commissioners (NAIC). Before joining the NAIC in 2006, he spent nine years at Wolters Kluwer Financial Services and more than 20 years of his insurance career with Allstate Insurance Company. Bieniek has handled all lines of insurance in a variety of capacities. In addition to serving as chair of the Regulatory & Legislative Interest Group, he is a board member of the Insurance Regulatory Examiners Society (IRES).

As we look forward to the weeks and months ahead of a new year, it's also natural to look back. And what a year 2009 was!

The economy is improving, health care is still a congressional discussion item and the Dow Jones Industrial Average Index mainly has stayed above 10,000. A report just out indicates the U.S. property-casualty business improved in the first nine months of 2009. Data indicates that insurers' net income after taxes rose to $16.2 billion and overall profitability rebounded from 2008 levels due to falling claim costs. All of that is good news.

The Regulatory & Legislative Interest Group Committee also has good news to report. Our committee was very active last year and plans to continue to help the CPCU Society and the industry's insurance professionals through 2010. On behalf of the committee, I'm proud to say that the Society awarded our interest group Gold Circle of Excellence recognition for the 2008–2009 program year.

The Interest Group Circle of Excellence Recognition Program commends interest groups for achieving specific benchmarks

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What's in This Issue?

Message from the Chair

Continued from page 1

Joseph F. Bieniek, CPCU, AIE, CCP, CIC, ARC, MCM, AIS, AU, (back row, third from the left) represented the Regulatory & Legislative Interest Group at the Circle of Excellence Luncheon in Denver, Colo. He is shown here with other interest group representatives; Marvin Kelly, CPCU, MBA, 2008–2009 CPCU Society president and chairman, first row, fourth from left; and James R. Marks, CPCU, CAE, AIM, chief executive officer, first row, first on left.

in performance. Interest groups can earn bronze, silver or gold recognition by undertaking activities divided among the key initiatives of the CPCU Society's strategic plan. We did it!

Circle of Excellence
Recognition Program

Our committee has developed Mission and Vision Statements on behalf of the Regulatory & Legislative Interest Group. We believe they will help guide us into the future and provide valuable information to our industry. Our mission and vision are as follows:

Mission Statement

In a regulated industry where "compliance matters," we provide information and insight on the laws and regulations affecting the business of insurance. We promote healthy discussion and dialog on the rapidly evolving federal and state regulatory insurance arena.

Vision

The Regulatory & Legislative Interest Group strives:

- To be the first place Society members choose to learn about proposed or recently enacted insurance laws and regulations.
- To be recognized within the Society as one of the premier interest groups.
- To provide relevant regulatory information about all countries, including those that may impact the United States marketplaces.
- To be a trusted source of information about the various United States insurance markets.
- To provide a forum for discussion on pertinent regulatory or legislative issues.

We will strive to meet and exceed these goals as well as provide CPCU Society members with valuable information. Two points in our Mission Statement call for providing timely information and promoting a healthy discussion on regulatory changes. Perhaps the best way we can accomplish this is with the group we established on LinkedIn.

Our group is open to anyone in the insurance industry, so please encourage others within your organization to join us and post items or questions that are important to them. The group's LinkedIn Web site includes areas where ***you*** (members of this LinkedIn group) can post news items, post discussion items and respond to discussions.

To join our LinkedIn group, you must first establish a free member account. Log on to **www.linkedin.com** and follow the directions to join. To find the Regulatory & Legislative Interest Group, select "Groups" in the top menu bar, type "CPCU Society Regulatory and Legislative" in the "Search" field and click on the search button. Select the Regulatory & Legislative group and then click on the "Join" button. It's that easy!

Speaking of Web sites, we now have new material on our CPCU Society Regulatory & Legislative Interest Group Web site, **http://rl.cpcusociety.org/,** and have refreshed it several times. You'll find a list of committee members working for you, news feeds, general information, news about upcoming events, a summary of our committee meetings, a calendar of events, past newsletters and whatever else we or you might come up with sharing. ***Please,*** if you have suggestions, let us know.

One of the seminars held at the CPCU Society's 2009 Annual Meeting and Seminars in Denver was the "Insurance Commissioner Roundtable," sponsored by the Regulatory & Legislative Interest Group. This was an informative and interactive session, moderated **Roger H. Schmelzer, J.D., MPA,** president and CEO of the National Conference of Insurance Guaranty Funds (NCIGF). Commissioner **Marcy Morrison** of Colorado and Commissioner **Mike Geeslin** of Texas were presenters.

Four of the many topics discussed are as follows:

- The Obama administration's plans to modernize and increase the regulation of financial services, including the introduction of systemic risk regulation.
- An Optional Federal Charter (OFC).

- Representative Barney Frank's proposed Consumer Financial Protection Agency, which would create a new consumer protection agency to regulate home loans, credit card fees, payday loans and other forms of consumer finance.
- The U.S. and international issues related to Solvency II and the Solvency Modernization Initiative (SMI).

Nearly 100 attendees packed the "Insurance Commissioner Roundtable" seminar in Denver. Commissioner Mike Geeslin of Texas and Commissioner Marcy Morrison of Colorado discussed important issues and legislative agendas of the day.

The two-hour session was too short a period of time to cover all of today's important initiatives and trends, but it proved extremely worthwhile. The seminar was one of the largest attended sessions of the Annual Meeting.

On Nov. 4, 2009, our interest group conducted a 1 1/2-hour webinar, which provided an overview on credit-based insurance scores — a hotly disputed public policy issue. Consumer advocates claim the scores are unfair to certain economically disadvantaged groups while insurers advocate for their use as a risk management tool.

The webinar included speakers representing the state regulatory system and one of the credit reporting agencies, as well as an insurance industry trade representative and a consumer advocate. Among the topics discussed was whether or not the economic downturn caused, or will be causing, a greater proportion of adverse insurance scores for consumers, resulting in these policyholders paying higher insurance rates and premiums than they do now.

The 2010 Annual Meeting and Seminars will be held in Orlando, Fla., from Sept. 25–28. The theme for the conference is "CPCU: Your Bridge to the Future." The Regulatory & Legislative Interest Group Committee will conduct a workshop titled, "Back to the Future — The Journey of Insurance Regulation." We have to get out our crystal balls for this one. The session will cover the past, present and future, as we will retrospectively consider what people say in the future about our industry and the impact regulation and laws are having on the present and have had on the past.

The seminar should be fun and enlightening to anyone in our industry. Participants will be able to join in a thought-provoking program on the evolution and dynamics of the regulatory climate and how the industry goes through periods of regulatory change and why. We hope you will be able to join us in Orlando for this event. Check our Web site often for updates on the seminar, and "Marty and the Professor" will provide information about insurance regulation. (Join us at our 2010 Annual Meeting seminar to discover the identities of "Marty" and the "Professor.")

We recently experienced some turnover in committee members. I am sorry to say that **Marsha A. Cohen, CPCU, ARe,** and **Ethan D. Lenz, CPCU, J.D.,** are no longer on the committee. Marsha is now on the Reinsurance Interest Group Committee, and I know she will be active and helpful.

I am happy to say that we have three new members: **Angelina D. Edouard Banks, CPCU, J.D.; Aaron Lunt, CPCU;** and **John D. Reiersen, CPCU, CIE, CFE.** Angie attended our committee meeting in Denver and was an active participant. Although he is new to our committee, Aaron is now our webmaster and already has some good ideas for our Web site. John is one of the founding fathers of our committee, so I feel fortunate to have him back with us.

There has been a healthy discussion in our industry on state versus federal oversight of the insurance industry. And there has been much discussion — and some narrow viewpoints expressed — that perhaps the economy collapse in the fall of 2008 was caused by our industry. A proposal relative to federal oversight was introduced in Congress last year, but because of the time spent on U.S. health care, Congress did not take up the proposal. However, representatives are sure to take it up once again in 2010 during the 112th Congress. This issue of our newsletter includes four articles providing you with the pros and cons of an optional federal charter. I hope you enjoy them as much as I have.

I will listen to your needs and act as a champion to implement your plans of what you would like your Regulatory & Legislative Interest Group to do. I would like to hear from you. My e-mail is jbieniek@naic.org and my phone number is (816) 783-8226. Give me a call or drop me a note with your comments and suggestions. ■

Comments from the Editor

by Eric C. Nordman, CPCU, CIE

Eric C. Nordman, CPCU, CIE, is currently the director of regulatory services with the National Association of Insurance Commissioners (NAIC). He directs the research division staff in a wide range of insurance research, supporting NAIC committees, task forces and working groups. He has been with the NAIC for 18 years. Prior to his appointment as director, Nordman was a NAIC senior regulatory specialist. Previously, he was with the Michigan Insurance Bureau for 13 years. Nordman earned a bachelor's degree in mathematics from Michigan State University. He is a member of the CPCU Society's Kansas City Chapter.

Welcome to this edition of the Regulatory & Legislative Interest Group newsletter. Always remember that compliance matters. The newsletter contains information discussing legal and regulatory matters related to regulatory compliance.

This issue starts off with some words of wisdom from our committee chair, **Joseph F. Bieniek, CPCU, AIE, CCP, CIC, ARC, MCM, AIS, AU.** Joe provides a retrospective look at 2009 and writes about the interest group's adoption of a Mission Statement and a Vision Statement. You will find his column interesting reading.

So you know what's going on with the insurance regulators, our always popular NAIC update is the lead article in this issue. The article covers the NAIC 2009 Winter National Meeting that was held in San Francisco, Calif., in early December, and documents issues important to the property-casualty industry and to insurance producers.

The focus of the rest of this newsletter issue is on the topic of state versus federal regulation. I am sure you will enjoy each of the four thought-provoking articles included. The opinions expressed in these articles are the responsibilities of the authors alone and do not imply an opinion on the part of officers, individual members or staff of the CPCU Society. Readers are invited to submit comments on these articles or other articles on the topic or related topics.

Appearing on the side of federal regulation are **David F. Snyder, CPCU, J.D.,** the American Insurance Association, and **Erik A. Sikorski, CPCU, AIC.**

Appearing on the side of "truth, justice and the American way" in support of state regulation are **Robert Detlefsen, Ph.D.,** the National Association of Mutual Insurance Companies, and me. OK … so I have to admit to some bias that might have been apparent in the previous sentence. To encourage a healthy debate is one of the functions of this newsletter and interest group.

Enjoy!!!! …. And don't forget to write. ■

NAIC Update — The 2009 Winter National Meeting

by Eric C. Nordman, CPCU, CIE

The National Association of Insurance Commissioners (NAIC) met from Dec. 4–9, 2009, in San Francisco, Calif. The Winter National Meeting is when the NAIC tries to wrap up its current projects in preparation for the coming year. There are many important projects underway that could change the property-casualty business. This article will highlight a few of them.

The Property and Casualty Insurance Committee

The Property and Casualty Insurance Committee met on Dec. 7, 2009. During this meeting, the committee heard reports from its three task forces and eight working groups and looked at several very important issues.

The committee discussed public policy issues related to a regulatory exclusion contained in directors and officers (D&O) policies in response to a request from the Receivership and Insolvency Task Force. Certain regulatory exclusions contained in D&O insurance policies pertain to receivers, conservators and liquidators, and the Task Force expressed concern that the use of the exclusionary language would become more common and potentially hinder the receiver's ability to exercise and enforce all the rights, remedies and powers of any insured, creditor, shareholder or member. This would result in a limitation of the receiver's ability to collect all monies due to pay claimants.

The committee was concerned with the practice of D&O insurers including a regulatory exclusion in their policies. The issue is whether the receiver, conservator, liquidator or state guaranty funds should be afforded coverage for acts of directors and officers of an insolvent insurer. There are financial implications for the public and all insurers through their participation in guaranty funds.

The committee agreed to send a notice to every jurisdiction informing them of the issue, as perhaps each jurisdiction may want to disapprove existing forms. In addition, a referral will be made to the Receivership and Insolvency (E) Task Force to consider including language disallowing such exclusions in the Insurers Receivership Model Act.

The committee, in association with the NAIC Market Regulation and Consumer Affairs Committee, has been conducting a series of public hearings on the use of credit-based insurance scores for underwriting and rating personal lines policies. In December, the committee discussed what to do with the information gained during the hearings. The committee agreed to conduct a conference call in January 2010 to consider a list of questions that will be used for a data call of all personal lines writers using credit-based insurance scores in all participating jurisdictions. The results of the data call will be compiled and evaluated to provide policymakers with information on the use of credit-based insurance scores. The purpose of the data call is to gain insight on the range of values employed by insurers with regard to their use of credit-based insurance scores for pricing.

The committee heard a report from its Catastrophe Insurance Working Group on a public hearing that it held on Dec. 7. The committee learned that there has been exposure to property damage and health effects from allegedly defective Chinese drywall imported into the United States between 2004 and 2007, resulting in a spike in property damage and bodily claims. The drywall has been installed in over 100,000 homes in 32 states, and the Consumer Product Safety Commission has recorded nearly 2,100 reports of defects. There are costs to repair homes, increased health costs, legal fees for the plaintiffs' lawyers, defense costs and indirect costs.

Testimony was received from **David Kodama,** senior director of research and policy analysis for the Property Casualty Insurers Association of America (PCI), who advised that insurance companies would continue to review each claim to determine coverage. He maintained that this is a complicated issue because, although there is correlation to the presence of alleged defective Chinese drywall, there is no direct causation from the drywall that has been conclusively established.

The working group also heard from consumer advocate **Amy Bach,** executive director of United Policyholders, who said the impact includes renters, homeowners, contractors, builders and suppliers. She hoped there would not be a panic situation, even though the potential exists for the overall dollar impact to exceed the hurricanes of 2004 and 2005.

Charles Miller, a principal of the Insurance Law Center in Berkeley, Calif., testified that he believes regulators should conduct multistate market conduct examinations of insurers to assure that insurers were properly investigating and settling claims in accordance with policy language. Miller suggested that regulators should develop a model guideline on the protocols to be followed by insurers in investigating and settling Chinese drywall claims.

The committee discussed the recent announcement by the Council of Insurance Agents & Brokers and

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NAIC Update — The 2009 Winter National Meeting

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LexisNexis on forming a partnership to build an insurance exchange. The purpose of the exchange would be to automate the transmission of information between insurance distributors and insurance intermediaries and, in addition to workflow efficiencies, enable access to key market information and analytics for better decision-making. The exchange allows brokers to see insurance product availability, pricing and coverage differences from multiple insurance carriers, which thereby enable them to place business that best matches their client needs. The exchange apparently uses a patented business process developed by Marketcore Inc. The insurance exchange will initially concentrate on commercial lines. All sizes and lines of property-casualty insurance will eventually be supported, with other lines of business to be added thereafter. A detailed and formal presentation will be made by the Council of Insurance Agents & Brokers at an upcoming NAIC national meeting.

The Surplus Lines Task Force discussed the NAIC Online Premium Tax for Insurance (OPTins) being used by some states to collect surplus lines premium taxes. The task force believes OPTins might be more widely used to streamline the processing of surplus lines premium taxes. The task force continues to discuss various ways to address the state nuances in calculation and collection of surplus line taxes, including federal legislation, standardizing business processes and developing an interstate compact.

The Workers Compensation Task Force continues to work on a best-practices guidance document to help states implement the *Guidelines for Regulations and Legislation on Workers' Compensation Coverage for Professional Employer Organization Arrangements*. The task force learned that the medical component of the workers' compensation system is now accounting for greater than 50 percent of the losses for the first time ever. The task force sent written comments to the National Conference of Insurance

Legislators (NCOIL) on its Construction Industry Workers' Compensation Coverage Act. The task force learned that NCOIL did not take any of the suggestions presented.

The Crop Insurance Working Group continues to work with states so states can avoid possible federal preemption of crop adjuster licensing. Through the working group's efforts, all 14 affected states plan to implement changes so that federal preemption will not occur. The Federal Crop Insurance Corporation's Risk Management Agency recently approved the Crop Adjuster Proficiency Program, which will provide the proficiency examination that will be used instead of state-based testing. National Crop Insurance Services is responsible for developing and administering the Crop Adjuster Proficiency Program.

The Market Regulation and Consumer Affairs Committee

The Market Regulation and Consumer Affairs Committee met Dec. 8, 2009. During this meeting, the committee received presentations regarding the insurance industry's perspective of the data elements collected with the Market Conduct Annual Statement. Presentations were given by representatives from the life-annuity industry and the property-casualty industry. Both presentations concluded that certain data elements were causing confusion among companies required to complete the Market Conduct Annual Statement. The life-annuity industry presentation stated that the data elements asked for in the Market Conduct Annual Statement were already collected in the annual financial statement. The committee discussed future activities of the newly formed Market Information Systems Task Force. The task force will oversee the automation of processes developed by the other market working groups.

The committee discussed a proposed complaint reconciliation process. The process would allow companies to ensure all complaints identified as belonging to them would be coded accurately.

The committee received a report from the Special Accreditation Standards Working Group and learned that the working group had requested that an executive-committee-level working group be formed to oversee the development of a market accreditation program. This will assist in ensuring that market accreditation is given the proper priority by insurance commissioners.

The Financial Condition Committee

The Financial Condition Committee has been working on a white paper titled, "Alternative Mechanisms for Troubled Companies." The white paper was adopted by the committee at its recent meeting. Insurance regulators have well-developed receivership laws, practices and procedures to handle impaired and insolvent insurers. These laws, practices and procedures are primarily concerned with consumer protection from the adverse affects of an insolvency. They are a critical part of the regulatory solvency framework.

Recent improvements with regard to the early detection of financially troubled insurers and insureds' requirements for A-rated coverage have led to a new paradigm for financially troubled insurers. Often, a run-off or restructuring is considered as an alternative to being placed in traditional receivership proceedings. As a result of a changing landscape and the fact that the NAIC has little formal documentation available to regulators dealing with alternative mechanisms for winding-down troubled companies, the committee appointed a Restructuring Mechanisms for Troubled Insurers Subgroup and asked it to draft the white paper. The subgroup consisted of experts involved in the active solvency monitoring process, as well as the receivership process.

The subgroup was asked to undertake a study of the following:

- Alternative mechanisms, such as solvent schemes of arrangement, solvent run-offs and Part VII portfolio transfers (a transfer leaving no recourse to original contractual obligor/insurer) — and any other similar mechanisms — to gain an understanding of how these mechanisms are used and implemented.
- The potential effect on claims of domestic companies, including the consideration of preferential treatment within current laws.
- How alien insurers (including off-shore reinsurers) that have used these mechanisms might affect the solvency of domestic companies.
- Best practices for insurance departments to consider if using similar mechanisms in the United States and/or interacting with aliens who have implemented these mechanisms.

The study is limited to situations where the legal entity is in a financially troubled condition that could potentially lead to an insolvency in the foreseeable future. The subgroup did not consider situations where the insurer is merely inconvenienced by a particular book of business or wishes to exit the insurance business for reasons unrelated to solvency.

The committee received information on a paper titled, "United States Insurance Financial Solvency Framework," that was drafted by **Mary Weiss, Ph.D.,** NAIC visiting professor, and **Raymond Spudeck Ph.D.,** senior research economist with the Florida Office of Insurance Regulation. The purpose of this paper is to describe the framework of the U.S. insurance financial solvency system and present a set of core financial principles underlying this framework. The paper provides a description of the solvency framework that draws upon ideas developed by the International Association of Insurance Supervisors (IAIS).

In many ways the U.S. solvency system goes beyond the IAIS baseline recommendations for jurisdictions. In the U.S. regulatory system, ongoing collaborative regulatory peer review, regulatory checks and balances, and risk-focused financial surveillance form the foundation of the regulatory process. The framework notes that the U.S. Insurance Financial Solvency Core Principles are embodied in the NAIC's Financial Regulation Standards and Accreditation Program — a uniform program to which all states subscribe. The paper includes a discussion of the U.S. Insurance Financial Solvency Core Principles. The document is available on the NAIC Web site, and comments are invited. Comments will likely be discussed and considered on a January 2010 conference call. ■

2009–2010 Regulatory & Legislative Interest Group Committee

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The Rise and Fall of Federal Insurance Regulatory Reform

by Robert Detlefsen, Ph.D.

Robert Detlefsen, Ph.D., is vice president of public policy at the National Association of Mutual Insurance Companies (NAMIC), an Indianapolis-based national trade association that represents more than 1,350 property-casualty insurance companies. In this role, Detlefsen conducts public policy research and analysis and coordinates the development of NAMIC's issue agenda and advocacy campaigns. Previously, Detlefsen was a vice president at the public affairs firm of Powell Tate in Washington, D.C. He is the author of one book and numerous articles and reviews, and has testified on several occasions before state legislative committees and regulatory bodies. Detlefsen holds a Ph.D. in political science from the University of California, Berkeley.

For the past several years, the seemingly endless debate over the future direction of U.S. insurance regulation has focused on proposals to create an optional federal charter (OFC) for insurance companies. Supporters of an OFC emphasized that their goal was to create a federal regulator that would peacefully co-exist with, rather than supplant, the existing state-based system. Under an OFC, every insurer would be allowed to choose, according to its preference, whether to remain subject to the existing state-based system or to be regulated under a new federal regime. Providing insurers with a federal regulatory option under which they would be exempt from most state insurance laws would (so the argument went) decrease compliance costs, remove barriers to market entry, improve underwriting and pricing accuracy, and enhance competition.

Many observers were skeptical that things would work out this way. Viewed through the lens of history, it seemed unlikely that optional federal chartering would remain optional for long. The scope and influence of the federal government had expanded enormously during the 20th century, often at the expense of state and local authorities. The dual system of bank regulation, which OFC proponents ironically cited as a model for dual insurance chartering, clearly demonstrated the tendency of federal lawmakers and regulators to predominate in a bifurcated regulatory system. Federal bank regulators, abetted by Congress and the federal courts, used the U.S. Constitution's supremacy clause together with the power of the federal purse to steadily usurp power from state bank regulators. Today, what little authority that still resides with state bank regulators is essentially delegated by their federal masters.

Also problematic was the notion that optional federal chartering would allow insurers to easily switch charters from state to federal and from federal to state as their needs and interests dictated. In reality, companies choosing a federal charter would likely find that the administrative cost of adapting to a new federal regulatory compliance regime would be quite high, and switching back to a state charter still more expensive, especially for multistate insurers that would have to apply for charters in every state in which they did business. From a practical standpoint, choosing a federal charter would permanently consign a company to federal regulation.

A powerful motivation for choosing a federal charter was the OFC's promise to preempt state rate regulation. Many OFC supporters jumped to the conclusion that there would be no rate regulation under a federal charter. But this was never more than wishful thinking. OFC legislation introduced in the 110th Congress stated only that the new federal regulator, dubbed the Office of National Insurance (ONI), could not impose "any particular rate, rating element or price." All this meant was that the ONI couldn't set rates in the way that Massachusetts once did with respect to private passenger automobile insurance. There was nothing in the OFC bill to prevent Congress from enacting a prior approval rating law — or laws restricting the use of certain underwriting variables — for federally chartered insurers. Indeed, the very same Congress in which OFC legislation had been introduced was also considering two bills that would ban the use of credit-based insurance scores.

Today, in the aftermath of the financial crisis and the 2008 elections, the likely consequences of an OFC law are less ambiguous and far more ominous than before the crisis. The version of the OFC proposal introduced in the 111th Congress, the National Insurance Consumer Protection Act of 2009 (NICPA), would produce none of the salutary modernizing reforms that critics of state insurance regulation once envisioned. The new OFC bill has been redesigned to take account of the financial crisis and the alleged culpability of AIG in contributing to it. NICPA thus makes federal chartering mandatory for any insurer deemed

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The Rise and Fall of Federal Insurance Regulatory Reform

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"systemically important" by an as-yet-to-be-named systemic risk regulator. Insurers not presumed to be systemically important that chose to retain their state charters could still be subject to federal intervention at the behest of the systemic risk regulator. And regardless of whether its federal charter was chosen or imposed, a federally regulated insurer could switch to a state charter only with the permission of the ONI. So much for unrestrained charter-switching, which had been touted by free-market advocates as a means of generating healthy competition between state and federal regulators. Today, having the ability to choose one's regulator is assailed as a recipe for regulatory arbitrage.

There are many more examples of how the politics of the OFC debate have been transformed during the past year. Indeed, the entire rationale for federal regulation has changed. Before the crisis, pressure for an OFC focused on three main concerns: costs and delays associated with regulatory approval of policy forms in 55 different jurisdictions; rate regulation that tends to suppress rates below insurers' projected costs; and restrictions on insurers' ability to accurately assess and classify risk.

Today there is no longer talk of liberating insurers and consumers from the shackles of state-administered price controls, underwriting restrictions and coverage mandates. Nor will one find any such provisions in the Treasury Department's proposed "Office of National Insurance Act," which would empower an ONI to recommend which insurers propagate systemic risk and should therefore be regulated by the Federal Reserve as "Tier 1 Financial Holding Companies." Indeed, the Treasury proposal allows for federal preemption of state solvency regulation, but specifically exempts from preemption state regulation of rates, forms, underwriting and terms of coverage.

The new proposals from Congress and the Treasury turn the original case for federal insurance regulation on its head. Before the financial crisis, it was generally conceded that despite market-distorting rate regulation in states such as Florida and California, state regulation had been remarkably effective in preventing and resolving company insolvencies. That, apparently, is no longer the view of those still clamoring for federal regulation. NICPA is portrayed by its supporters as necessary to prevent another AIG, whose demise is attributed to the failure of state insurance regulation. We are told that the near collapse and subsequent quasi-nationalization of AIG is evidence that large, internationally active insurance companies are ipso facto systemically important, and must therefore be subject to federal oversight to prevent future systemic crises.

Of course, AIG's failure had nothing to do with ineffective state solvency regulation and everything to do with the colossal failure of federal financial regulation. By now it is widely understood that AIG's problems stemmed almost entirely from its financial products unit, which was actively (and ineptly) regulated by the Treasury Department's Office of Thrift Supervision. AIG's state-regulated insurance subsidiaries, insulated by state law from the noninsurance activities of AIG's holding company, remained solvent and continued to serve their policyholders throughout the crisis — even as dozens of banks and other federally regulated financial institutions failed. In effect, the current proposals for optional and mandatory federal insurance chartering seek to transfer prudential regulation from the regulators that proved most effective before and during the financial crisis to those that proved least effective.

The tone and substance of the current health care reform debate provide a sobering portent of federal insurance regulation should it eventually be applied to property-casualty insurers. As this is being written, the Obama administration and some members of Congress are engaged in a carefully orchestrated campaign to publicly vilify private health insurance companies for committing such atrocities as charging higher premiums for customers with pre-existing medical conditions. If federal regulation of property-casualty insurance comes to pass, there is no reason to believe that federal politicians and regulators will not eventually extend such attacks to risk-based underwriting and pricing for property-casualty insurance. After all, credit-based insurance scores and catastrophe risk exposure play the same role in property insurance underwriting and pricing that pre-existing medical conditions play in health insurance.

Federal insurance regulation as contemplated by both NICPA and the Treasury proposal would likely lead to broad restrictions on underwriting and pricing to achieve political or social goals. Federal insurance laws and regulations could end up looking very much like those that currently exist in the handful of states that exemplify inefficient and dysfunctional state regulation. The difference is that dysfunctional federal regulation would be national in scope. ■

A Coordinated National System of State-Based Insurance Regulation

by Eric C. Nordman, CPCU, CIE

The Issue

Insurance is an industry that is vested with public interest. While no one likes to have government tell him or her what to do, as a society we recognize that certain laws and regulations promote the public good and are accepted as necessary for the proper functioning of a modern society.

Insurance is a heavily regulated industry. While the economic well-being of Americans is affected by the adequacy of their insurance protection, they generally have little influence on the cost of the product or the terms of coverage. Individuals, families and businesses turn over vast sums of money[1] in exchange for a written promise to perform or pay for certain services if specified contingent events occur in the future. Thus, the insurance contract is one where trust is needed from both parties to the contract, but one party is in a much more powerful position than the other. Therefore, insurance is regulated. This paper addresses the form of regulation and will cover the age-old question of which is best for property-casualty insurers — state or federal regulation?

Background

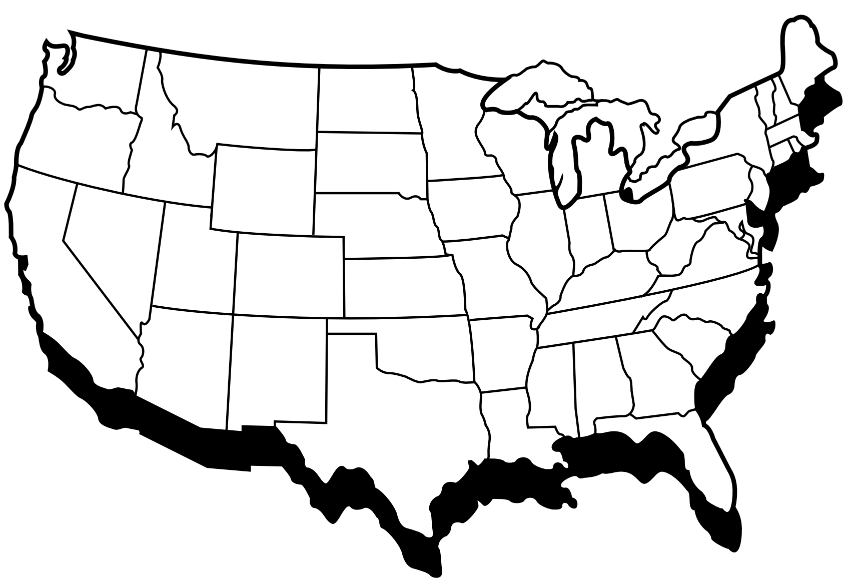
The first meeting of the National Convention of Insurance Commissioners (later known as the National Association of Insurance Commissioners or the NAIC) was held in New York City on May 24, 1871. New York Superintendent George W. Miller opened the meeting by reading a letter that he had written to all insurance commissioners, superintendents and directors on Feb. 3, 1871. In pertinent part, Superintendent Miller's letter states:

> "... the ... increase in the number of state departments, each established under different laws and adopting different forms, rules and regulations, has naturally tended rapidly to increase the labors and consequent expenses of insurance companies ... .
>
> "As the people of every state are interested in procuring insurance which shall be reliable, and, at the same time, cost as little as possible, it would seem that some measures might, and if possible, ought to, be adopted, which would promote the general interests of the insurer and the insured."[2]

While the grammar and phrasing have changed over time, the superintendent's observation was very insightful. He noticed that the divergence of state laws and regulations was expensive and inconvenient for insurers and that the cost of compliance is passed along to their policyholders. His idea for state insurance regulators to work in concert whenever possible serves as the foundation for the current coordinated national system of state-based insurance regulation that is employed today.

Complaints about State-Based Insurance Regulation

Detractors of state-based insurance regulation point to a laundry list of complaints. They say it is too expensive, too burdensome, too complicated and too political — plus it is inconvenient, it hinders bringing products to market on a timely basis and globalization demands a single national regulator. What they don't say is that it does not work. It does work, and during the recent economic downturn, there is ample evidence supporting that state-based insurance regulation performed much better than other federal financial services regulators and financial regulators in other nations.



Why State-Based Insurance Regulation Works Best

The coordinated national system of state-based insurance regulation has a proven track record of success and has, over time, consistently and effectively been up to the challenge when improvements are needed. What do we mean by a coordinated national system of state-based insurance regulation?

The statutory framework for today's insurance regulatory system has evolved over time. It is grounded in the McCarran-Ferguson Act of 1944,

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A Coordinated National System of State-Based Insurance Regulation

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which was reaffirmed by the Gramm-Leach-Bliley Act of 1999. In it Congress delegates the authority to regulate and tax the business of insurance to the states, unless Congress specifically acts to reclaim some or all of that authority. While each state legislature has enacted a series of laws to regulate and tax the business of insurance, these laws recognize that often it is more efficient for states to act in concert instead of independently. For example, it would be inefficient and duplicative for each state to develop its own unique financial reporting mechanism, and as a consequence, states have come together to develop and codify a uniform set of financial accounting standards and a uniform method by which insurers report financial data.

The regulatory framework for solvency oversight came into question in the late 1980s, when, in response to several significant insurer failures, the Subcommittee on Oversight and Investigations of the House Committee on Energy and Commerce issued its Failed Promises Report.[3] In response, regulators were up to the challenge and created the NAIC's Accreditation Program, which ensures all accredited jurisdictions meet baseline financial solvency oversight standards. The accreditation standards require state insurance departments to have adequate statutory and administrative authority to regulate an insurer's corporate and financial affairs, as well as the necessary resources to carry out that authority.

The positive results were evident in the recent financial downturn. While over 153 banks failed since October 2008[4], there were less than 10 insurers that failed — a testimony to the effectiveness of state financial regulatory oversight. Insurers have weathered the storm relatively better than other financial services providers in large part because of the conservative state laws regulating insurers' investment activities, constant evaluation of the wealth of financial information regularly provided to regulators and active cross-border information sharing and resulting coordinated regulatory action.

The coordinated national system of state-based insurance regulation provides uniformity where it is crucial and allows for diversity where it is not. As mentioned previously, there is a very high level of uniformity in the financial statements and insurance accounting standards. As a fail-safe measure and to minimize political motivations that might affect solvency monitoring, the states have enabled a peer review process so that financially troubled insurers are not overlooked.

"… the insurance contract is one where trust is needed from both parties to the contract, but one party is in a much more powerful position than the other. Therefore, insurance is regulated."

Through the work of the Financial Analysis Working Group (FAWG), state financial regulators collectively monitor the financial health of the nation's insurers. The FAWG process is intended to ensure that the domestic regulator is taking effective action when a multistate insurer is or appears to be having financial difficulties. This interstate coordination is helpful to domestic regulators in analyzing the financial condition of an insurer and overcoming any significant political clout a major domestic insurer might have within that state.

There are some areas where uniformity is not necessary. In areas of diversity, state insurance regulators have often come together to develop uniform processes that make it easier for insurers and insurance producers to achieve regulatory compliance. Examples where uniformity of process have prevailed include the NAIC's System for Electronic Rate and Form Filing (SERFF) and development of the National Insurance Producer Registry (NIPR).

SERFF is an electronic tool that allows insurers to file insurance products with state regulators using a cost-effective system designed to enable companies to send and states to receive, comment on, and approve or reject insurer rate and policy form filings. Over 500,000 filings are processed through SERFF each year, providing efficient speed to market for insurance products at reasonable cost to more than 2,950 unique, currently licensed insurance companies. The NAIC also has several other speed-to-market initiatives that insurers have been using to move their products to the marketplace.

The NIPR is a nonprofit affiliate of the NAIC, governed by a 13-member board of directors with six members representing the NAIC, six industry trade association representatives, including three insurance producer trades and the CEO of the NAIC as an ex-officio voting board member. The NIPR operates the Producer Database (PDB) and the NIPR Gateway. The PDB is an electronic database consisting of information relating to insurance agents and brokers (insurance producers). The PDB links participating state regulatory licensing systems into one common repository of producer information. The PDB also includes data from the NAIC's Regulatory Information Retrieval System (RIRS) to provide a more comprehensive producer profile.

The key benefits of PDB are increased productivity, less cost, reduction or elimination of paper, national verification of producer license and status, and a single source of data. The NIPR Gateway is a communications network that links state insurance regulators with the entities they regulate to facilitate the electronic exchange of producer information. Data standards have been developed for the exchange of license application, license renewal, and appointment and termination information. The key benefits of NIPR Gateway are reduction or elimination of paperwork and data entry, use of uniform national standards regarding electronic transmission of licensing data and faster turnaround time, including real-time access in some states.

State insurance departments focus on consumer protection activities that manifest themselves in a number of areas that impact property-casualty insurers. While bank regulation focuses on safety and soundness — the bank regulatory jargon for solvency monitoring — insurance regulation has a dual focus of solvency and consumer protection. The products sold by property-casualty insurers reflect differences in the state laws and the state civil justices systems. Thus, when considering which level of government — state or federal — would regulate property-casualty insurers, unless Congress is willing to overturn state auto insurance, workers compensation benefit structures and state court systems, then a federal insurance regulator or an optional federal charter for property-casualty insurers makes little sense.

The federal regulator would still have to learn about each state's laws and regulations to make the system work. In the case of an optional federal charter, the dual system would only lead to increased costs for everyone since the federal regulator would in essence have to learn and implement the current state-based regulatory system without massive Congressional preemption of state laws. Further, the concept of regulatory arbitrage would be introduced.

Regulatory arbitrage occurs when the regulated entity is able to choose its regulator. This inevitably leads to competition among the regulators to lower, rather than raise the regulatory standards for both financial and market regulation to entice the regulated entities to select them as their preferred regulator. This would be disastrous for both consumer protection and solvency oversight. With the recent economic woes, the country is not ready for more lax regulation that increases the likelihood that things will go bad.

Globalization

Globalization of the financial and insurance markets is often offered as a compelling reason for the U.S. to have a single national regulator. The same arguments could be made for having a single international regulator, but nobody is discussing that possibility.

Who is calling for a single national U.S. regulator? Generally, it is the European insurers and European insurance regulators that express concerns with the U.S. regulatory framework. I would argue that it is much easier for a European insurer to gain a foothold in the U.S. than it is for a U.S. insurer to operate in Europe. A European insurer must deal with 56 regulators operating in a coordinated national system of state-based insurance regulation but only one language and one currency — the U.S. dollar. They have access to more than 300 million people and the world's wealthiest population on a per capita basis.

A U.S. insurer trying to gain a foothold in Europe must deal with 27 national regulators using 23 different languages and the Euro plus 10 other currencies. Even then not all of the markets can be accessed, as some of the nations in Europe do not belong to the European Union[5]. The European Union does have more people (almost 500 million); however, the per capita wealth is less per person. As evidence of this occurring, one needs only to look at recent acquisitions. Allianz now owns Fireman's Fund. Zurich has bought both CNA and Farmers Insurance Group. Swiss Re purchased major U.S. reinsurer Employers Reinsurance Corporation. There is not a comparable list of U.S. insurers buying European insurers.

The Solution

Don't fix what is not broken. State insurance regulators have a proven track record of solid financial oversight and consumer protection in a coordinated national system of state-based insurance regulation. While a continuous improvement process is always necessary, it is not state-based insurance regulation that is the problem. Instead of considering an overhaul of a system that is providing positive results, Congress should concentrate on making the markets for risky securities more transparent so that the buyers know about the underlying elements of each bundled security that they are purchasing. Congress should make appropriate amendments to the Gramm-Leach-Bliley Act and the Commodity Futures Modernization Act of 2000 so that effective oversight of economic activity occurs. State insurance regulators also suggest that federal financial services regulators look to state insurance regulation as a model regarding, among other things, restrictions on derivative activities, limits on high concentrations in investment types and appropriate solvency requirements. ■

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(1) $446 billion in written property-casualty premiums for 2008.

(2) Olcott, Henry S. "Official Report of the National Insurance Convention." J. H. and C. M. Goodsell. New York: May 24, 1871. P. 1.

(3) Dingell, John D. et al. "Failed Promises: Insurance Company Insolvencies." U.S. Government Printing Office. Washington, DC. February 1990.

(4) Failed Bank List, Federal Deposit Insurance Corporation (http://www.fdic.gov/bank/individual/failed/banklist.html).

(5) There are currently three "candidate" countries and 19 countries in Europe that are not participating in the European Union. (http://europa.eu/abc/european_countries/others/index_en.htm).

Insurance Regulatory Reform — Now More Necessary and More Likely than Ever

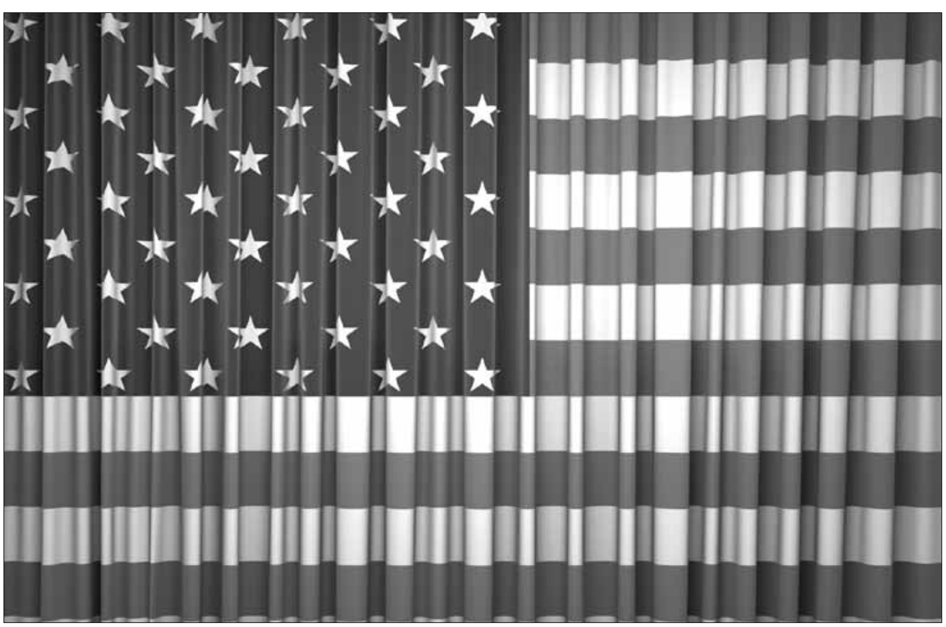
by David F. Snyder, CPCU, J.D.

David F. Snyder, CPCU, J.D., is vice president and assistant general counsel of the American Insurance Association (AIA).

While the issue of insurance regulatory reform has previously arisen in the states, in international forums, at the National Association of Insurance Commissioners (NAIC) and in Washington, recent events and actions have deepened and quickened the momentum for reform. No one interested in insurance and insurance regulation can afford to ignore or minimize the importance of these regulatory reform developments.

Recent International and U.S. Events Are Driving Change

On April 2, 2009, in the midst of the worst economic turmoil in 80 years, the heads of state of the world's greatest nations, including President Obama, committed to a comprehensive program of global financial services regulatory reform, international cooperation, anti-protectionism and enhanced trade. They stated that: "We face the greatest challenge to the world economy in recent times; a crisis ... which affects the lives of women, men and children in every country, and which all countries must join together to resolve. A global crisis requires a global solution." If the words of the world's leaders mean anything at all, fundamental change will happen.



The words apparently do mean something. On June 17, the Obama Administration issued its white paper on financial services regulatory reform. While the paper did not call for the immediate creation of a national insurance regulator, it was highly critical of the current U.S. insurance regulatory system, referring to it as "fragmented" and "inefficient."

The paper also laid the foundation for the Administration's support for further reform, setting forth six principles that would guide its support:

- Effective systemic risk regulation.
- Strong capital standards.
- Meaningful and consistent consumer protection.
- Increased national uniformity through either a federal charter or effective action by the states.
- More consolidated regulation of insurance companies and affiliates.
- International coordination.

Legislative proposals to implement the white paper's sweeping recommendations have since been released.

On July 28, the Committee on Banking, Housing and Urban Affairs of the U.S. Senate held a hearing with a particularly interesting discussion of the regulatory reform issues by the panelists. Two academics identified significant problems with the current insurance regulatory system and suggested ways forward. **Martin F. Grace, J.D., Ph.D.,** James S. Kemper Professor of Risk Management and Associate Director of the Center for Risk Management and Insurance Research, J. Mack Robison College of Business, Georgia State University, emphasized the need for national systemic risk regulation, as well as the need to avoid costly duplicative regulation, and expressed well-considered doubts about the ability of the state-based system to do either. Meanwhile, Hal S. Scott, J.D., the Nomura Professor and Director of the Program on International Financial Systems at Harvard Law School, criticized the status quo of state-based regulation for a variety of reasons, including inefficiencies, lack of uniformity, impediments to innovation and speed to market, and because its fragmentation puts U.S. insurers at a competitive disadvantage.

Developments in Washington Are Defining the Key Problems and Solutions in the U.S.

New systemic risk regulation is generally deemed essential to assure that all aspects of financial conglomerates are being effectively regulated and to assure that especially large or interconnected companies — so-called Tier 1 financial entities — receive enhanced supervision. A council of federal regulators has been proposed to oversee the entire financial system, assuring coordination and avoidance of gaps.

The Office of National Insurance (ONI) is to be the federal focus of expertise and information on insurance and the key subject matter expert representative of the U.S. in international trade and international insurance regulatory discussions. The ONI will be charged with monitoring the insurance industry for signs of systemic risk and for determining whether any insurers are designed as Tier 1 companies. The ONI will also serve as a resource to the financial services oversight council

Consumer protection functions for many financial services are to be carried out by the proposed Consumer Financial Protection Agency. Even though the legislation largely excludes insurance, it raises some serious concerns, including that it does not establish one set of clear national rules for businesses and consumers, but instead provides that the federal rules will only be a "floor," allowing multiple layers of potentially inconsistent regulation.

Corporate governance is being reviewed, and legislative proposals in this area are being aggressively advanced. Included in legislation are provisions on compensation being voted on by shareholders and provisions requiring that compensation better reflect beneficial performance.

Increasing Pressure for Reform Is Coming from International Bodies

Europe is implementing Solvency II, a new European Union-wide risk-based capital regime. To avoid discrimination against foreign insurance companies doing business in Europe, the regulatory regimes in the countries in which they are based will have to pass an equivalence test. European representatives have made it clear that the U.S. regulatory system will be judged on a national level, not a state-by-state level.

The International Association of Insurance Supervisors (IAIS), consisting of regulators from more than 100 countries, divides insurance regulation into three major components: solvency, corporate governance and market conduct. So far, it has been primarily focused on solvency regulatory issues and has published papers on solvency-related issues, along with several substantive standards. It has also worked on some tools for better international coordination among regulators, including a model memorandum of understanding to share information and supervisory colleges, which are joint reviews of a company by the regulators of multiple countries. Beyond solvency, IAIS is now coordinating with other organizations on an insurance company corporate governance initiative, and it is beginning to work on market conduct issues.

The Organization of Economic Cooperation and Development has coordinated with IAIS on corporate governance. It is also working on papers on how to assure both effective and efficient regulation. This work emphasizes transparent and open regulatory processes, using regulation as a last resort and assuring vigorous cost/benefit analyses for regulation. In my view, it is some of the most important and beneficial work being done at the international level.

The re-named and strengthened Financial Stability Board, the International Monetary Fund and the World Trade Organization, have all been directed by the G-20 to be more aggressive in carrying out their respective missions. Among their charges are enhanced coordination and convergence of solvency regulation, a vigorous review of the quality of regulatory systems and reporting on protectionist measures, including those masquerading as regulation.

Key Stakeholders Are Pressing for Reform

Property-casualty insurers largely avoided contributing to the financial turmoil. Even though they have prevailed in the face of daunting challenges, insurers and insurance regulators are swept into many proposals due to their being an inherent and indispensable part of the financial services system. In the debate, insurers emphasize that their operational model is different from banks and they should be regulated differently. Insurers also seek a U.S. and global regulatory system that is more uniform, cost/effective and pro-competitive. If better regulated, they argue, they will be better positioned to assist in the global recovery. Some

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consumer groups, as well, envision a role for federal regulation in the areas of systemic risk and international developments, but their vision of a regulatory model differs.

"Property-casualty insurers largely avoided contributing to the financial turmoil. Even though they have prevailed in the face of daunting challenges, insurers and insurance regulators are swept into many proposals due to their being an inherent and indispensable part of the financial services system."

An Effective and Efficient Insurance Regulatory System Is Important for Everyone

Property-casualty insurance, if well regulated to assure solvency and to encourage private sector market growth, competition and innovation, benefits societies in many ways. By compensating for loss, insurers help families and businesses return to productivity and governments to use funds in other ways. Insurers support infrastructure development through their investments, funding transportation facilities, hospitals, schools and other projects that help economies grow and improve the quality of life. Finally, insurers play a vital social role in reducing risk by pricing for it, educating the public about it and supporting private and governmental measures to reduce it. Simply stated, efficient and effective regulation that works to advance vigorous private insurance markets benefits everyone.

Conclusion

At no time in living memory have so many actions and events focused on the need to reform insurance regulation. Pressure for change is coming from governments and key stakeholders and from within and outside the U.S.

Insurance regulatory reform and a strong insurance system are viewed as potentially significant in solving the current global crisis and assuring a better future for the world. As the world's leaders said in the G-20 statement, our common goal is to "not only restore growth but lay the foundation for a fair and sustainable world economy." Efficient and effective insurance regulation that encourages competition, innovation and growth of private insurance can greatly assist in achieving this shared vision. ■

One Is More than Fifty

by Erik A. Sikorski, CPCU, AIC

Erik A. Sikorski, CPCU, AIC, has more than 15 years of industry experience leading various property-casualty claim departments in roles such as state claims manager, regional claims manager and director of claims, for companies with premiums in excess of a billion dollars. With strong technical knowledge of the claims handling process, he has applied his experience to the drafting and delivering of a wide array of training and education topics, including an accredited course on good faith claim handling. Sikorski has authored an insurance claims suspense thriller entitled, *The Package,* and is currently writing a second novel, entitled *Made Whole.* He can be reached at eriksikorski@yahoo.com.

Editor's note: The following article was written in the spring of 2009.

A perfect storm of events has brought the insurance industry to the precipice of a new regulatory environment as America moves through 2009 and beyond, and as a result, prudence demands our industry begin the dialogue with the legislators and lobbyists who will actually determine our regulatory fate in the years to come. The elections of 2008 brought a new majority to our nation with an innate mandate for change. The continued economic downturn, the frustration at Wall Street, and the disastrous practices of rogues such as Madoff and Stanford have created a public outcry, which will almost certainly bring new regulation across corporate America as well as the insurance industry. Therefore, it is imperative we recognize this scenario and take steps to ensure the industry determines its regulatory fate and not a headline-grabbing politician.

One of the great problems with insurance is the complexity of the various products that make up the industry. Merely tackling the issue of how to provide better regulation for the property-casualty industry alone alleviates life, health, disability and countless other lines of potential insurable products. Combine this with the need for simplicity in order to sell your message to a politician, and you have a recipe for failure. Therefore, let us approach the question of regulation from the perspective of consumers, who ultimately control the fate of the industry through the products they purchase, and the government, through the representatives they elect.

What or who determines the price of property-casualty insurance? As a 15-year veteran of the property-casualty industry, one of the most common complaints I've heard over the years focuses on price — "Why does my policy cost so much?" or "Will my rates go up with this claim?" The second question is always easier to answer than the first: "Yes, your rates will go up after your claim." The first question also deserves an answer, and sometimes the best one is simply, "I have many reasons why your policy costs so much, and none of them can I explain in the next week."

The insurance industry needs to bring a consistent approach to cost across all regions of the country, and this is a great place to start from a uniform regulatory approach because it allows insurance companies to reveal a multitude of actuarial data illustrating loss costs in every zip code of the United States. Allowing the numbers to tell a story of where it costs the most to handle and pay claims due to geographic and legal differences is something many consumers understand. Viewing a strictly geographical approach, the data illustrates areas where claims are most frequent and cost a particular amount. If a homeowners policy is issued on the coast of Alabama, Florida, Georgia, Louisiana, Mississippi, Texas or the Carolinas, the data will illustrate a specific history of loss frequency and severity that can be specifically traced to the number and force of hurricanes over the last 20 years.

> ***" … let us approach the question of regulation from the perspective of consumers, who ultimately control the fate of the industry through the products they purchase, and the government, through the representatives they elect."***

This data then provides a frame of reference to the public for the cost of the policy. This type of data is simple and transparent, thus providing appreciation and confidence to the general insurance consumer. The simple fact is that in recent years, the coastlines of the Gulf States have been struck by forceful hurricanes. Residents of these states

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may not like the cost of their insurance, but there is a valid reason behind the cost that is easily demonstrated and understood. A federal charter containing a pricing guideline based on historical data would streamline the ratemaking process and provide an objective basis for premium costs. Therefore, premiums would be based on actual historical loss data and be insulated from potential political issues, which could influence the current fragmented and separate regulatory system found at the state level.

Providing insurance consumers with an answer to "what" determines the price of their insurance is merely statistical data gathered and sorted based on years of loss experience. Unfortunately, the "who" portion of the question is slightly more complicated, but deserves equal consideration. Many consumers are of the impression the "who" is the insurance company issuing the policy. While that may seem to be the easy answer, I would argue an alternative. The responsible "who" are a collection of insurance executives, insurance commissioners and trial attorneys, and the following examples clearly illustrate their influence.

An insurance executive needs to make a production bonus; he then issues an edict to lower rates in a specific location in order to generate market share. The common customer has no understanding that the pursuit of a bonus for an executive has provided a break in the premium costs.

An insurance commissioner is interested in making a run at a higher political office, thus she mandates her office to issue a string of market conduct surveys to many of the carriers doing business in the state. As a result, the carriers increase rates or pull out of the state as a result of a negative insurance climate. Unfortunately, the consumer ultimately pays for political ambition.

A group of trial attorneys share information discussing their successful litigation against specific insurance

companies in cases handled by certain judges. They create a blueprint for future cases and consistently hammer the insurance companies in a particular state as a result of their litigation practices. The company responds by increasing premiums or pulling out of the state, ultimately passing the cost along to the consumer.

A federal charter governing the insurance rates and clearly illustrating the data on which the rates were determined can bring a clear light as to why it costs more to insure a vehicle in one state as opposed to a neighboring state of the same basic topography. No where in the nation is this better illustrated than Bluefield, Va., and Bluefield, W.Va.

These two towns are essentially one in the same, merely divided by a state boundary running down the middle. However, in 2004, living in Bluefield, W.Va., would cost you double in auto insurance premiums than living in Bluefield, Va. The reason? Simply, third-party bad faith as a private cause of action was recognized by the West Virginia judicial community and was unknown in the Virginia courts. Thus, the consumers of each side of the city pay vastly different premiums, but neither understands why. A federal charter would specifically list the cost considerations, providing consumers with the knowledge to understand their rates.

Clearly, the economic headlines of the last few months illustrate a need to remove the shroud of confusion and secrecy that hides the true cost of products. Consumers remain perplexed as to the reasons behind a $4 gallon of gas in August and a $2 gallon in January.

An insurance premium is no different. A federal charter clearly listing and governing the basis for a premium in a particular geographic area of the nation is an excellent beginning to bring clarity and stability to an insurance market based on the chaotic madness of 50 separate and unequal state regulators. ■

New York Working to Re-Establish the New York Insurance Exchange

by Stewart A. Keir, CPCU, CFE, and Robert A. Romano, J.D.

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Robert A. Romano, J.D., is a partner in Locke Lord Bissell & Liddell LLP's New York office. He practices in insurance regulatory, corporate and international matters. With more than 25 years of legal experience, Romano has worked extensively in surplus lines and reinsurance matters and insurance-related M&A and corporate finance transactions.

Editor's note: The following was originally published as a *Client Alert* by Locke Lord Bissell & Liddell LLP (LLB&L) and is used with permission. *Client Alerts* are published by LLB&L solely for educational and informational purposes and do not constitute legal advice.

The New York Insurance Exchange ("Exchange") may be back. The idea of re-establishing the Exchange has the strong support of Governor Paterson, Mayor Bloomberg and a number of legislators in Washington, D.C., and Albany, N.Y. In addition, New York Superintendent James J. Wrynn has now formed a Working Group (the "Working Group") to study how best to rebuild the Exchange.

The original Exchange, created by statute in 1978, was an attempt to emulate Lloyd's of London ("Lloyd's") and capture some of the business that was being placed overseas and offshore. The concept was to create a marketplace in New York, the financial services capital of the U.S., for reinsurance and more complex risks that were, for a number of reasons, being placed outside of the U.S. During the same period, Illinois and Florida also opened their own insurance exchanges. For a number of reasons, none of these operations were successful.

The New York statute that created the original Exchange remains on the books and allows underwriting syndicates to write several types of business:

- Reinsurance of all kinds, including life reinsurance.
- Non-U.S. direct business.
- Surplus lines insurance in other states.
- New York risks rejected by the New York Free Trade Zone, which permits a New York licensed property-casualty insurer to write insurance exempt from the normal New York rate and form filing requirements on certain unusual or high-loss hazard or difficult-to-place risks.

This legislation is broad enough to permit the creation of a new Exchange but may need revision or new regulations to meet the needs of today's markets and to avoid the challenges that the first Exchange faced.

To start this endeavor, Superintendent Wrynn invited a number of interested parties, including Stewart A. Keir, CPCU, CFE, our Locke Lord colleague and former chief of the New York Insurance Department Insurance Exchange and Excess Line Bureau, to participate in the Working Group. The Working Group met with the Superintendent on Jan. 21, 2010, and is scheduled to have a number of additional meetings over the coming months with the goal of having a final proposal for action in or about September 2010.

The Superintendent indicated the Exchange:

- Must benefit the insurance industry.
- Should have a New York City situs and backoffice operations upstate.
- Should seek to be rated by a recognized rating agency.
- Should have an advanced technology platform, standardized forms, contract certainty and expeditious claims handling.
- Should work with and complement Lloyd's.

Sub-groups will be established to work on specific areas:

- Regulatory oversight.
- Capitalization.
- Tax.
- Operations and technology.
- Multistate issues.
- Markets.
- Government relations.

If all proceeds on time and the results are favorable, the Superintendent would like the new Exchange to be up and running by 2011. Our firm will be following developments closely and participating in this process. If any of our clients or friends have questions or wish to raise issues, they are invited to give the authors a call. ■

Regulatory & Legislative Interest Group
Volume 17 • Number 1 • February 2010
Compliance Matters

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720 Providence Road
Malvern, PA 19355
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Address Service Requested

The Regulatory & Legislative Interest Group newsletter is published by the Regulatory & Legislative Interest Group of the CPCU Society.

Regulatory & Legislative Interest Group
http://rl.cpcusociety.org

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