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INSURANCE REGULATORY EXAMINERS SOCIETY

New York insurance regulators respond to aftermath of WTC

by Scott Hoober
Special to *The Regulator*

Even if you don't live in a California earthquake zone, a hurricane-prone Gulf Coast state or the Midwest's tornado alley, a catastrophe could strike anyone at any time.

But no one could ever have anticipated the magnitude of the disaster that struck New York on Sept. 11.

REGULATOR photo by Wayne Cotter

All the same, the state's insurance department was probably about as well prepared as any agency could have been. As a matter of fact, Superintendent Gregory V. Serio said, the terrorist attack was the first test of the department's new Insurance Emergency Operations Center (IEOC).

The Sept. 11 attack in lower Manhattan wasn't just larger than could have been anticipated. It also had a direct impact on department operations — the people who the public needed available to help them recover from disaster were themselves smack dab in the midst of the horror.

Unlike most state agencies in New York, insurance regulators (along with their counterparts in banking), are headquartered in the Big Apple. The Department of Insurance's offices occupy four floors of an office building just five blocks south of the World Trade Center, and they lost power and telephone service along with everyone else in that part of town.

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Remembering September 11

by Wayne Cotter
Editor

It's been nearly seven weeks since the devastating attack. Those of us working in downtown Manhattan are trying very hard to live normal lives, do normal things. But normal doesn't come easy with the militia guarding your streets, with your favorite shops and restaurants shuttered, and with the stench of smoldering rubble just a wind shift away.

Early on the morning of Sept. 11, the New York Insurance Department was preparing for a day-long seminar. The session was to take place near the East River, a few blocks south of the Department's Manhattan headquarters. (The Department is about five blocks south of the Trade Center.) Speakers had arrived and registration was proceeding as planned when the first ominous sign came into view: thousands of pieces

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From the President

We're still here, still family

Sept. 11, 2001 affected all of us. My ride picked me up that morning and, not having listened to the news, I remember thinking what a routine day it would be. Instead, we drove to Salem in shock as the radio announcer described the first tower crumble and then the second. At work, there was a sense of disbelief as we watched the horror unfolding on the other side of the country.

The next few days were even more unsettling as the shock wore off and reality set in. I learned that the brother of one of my employees, although injured, had survived and made it out of the building. Another friend's cousin had not.

At our division, we were startled to learn how many insurance-related organizations had offices in the WTC. We believe there are no IRES members among the missing or the dead. However, IRES member and Commissioner Al Gross from Virginia and some of his staff were at the WTC that morning, but escaped unharmed.

Now, a month later, we are still assessing the damages, both actual and to our psyche. And yet, it is not over.The threats to our national safety continue each day. IRES has always been as much a family as it is a professional organization. Its members are its biggest asset.

In my experience, I have never been let down when I have called on a fellow IRES member for help or advice. It is comforting to know that in this time of crisis we have each other to lean on and to draw encouragement and strength from.

As we move forward in this uncertain time, it's reassuring to know that the IRES family stands together in its support of each other. I know I speak for all IRES members when I say that our thoughts and prayers are with the victims and their families of this senseless violence.

Jann Goodpaster

Remembering September 11

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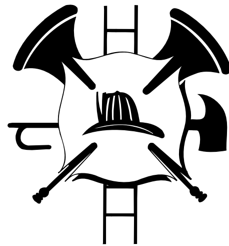
of paper, many singed, began swirling over the East River.

A few moments later we learned a plane had hit the North Tower. When news of the second attack arrived, the seminar was abruptly cancelled. I headed about two blocks northeast of the Department offices with a camera I had brought for the seminar. Having worked in and around the Trade Center for 25 years, I wanted to see the damage for myself. The photo on p. 1 shows the scene Insurance Department staffers witnessed that day.

About 15 minutes later, I made my way back to the street outside Department headquarters. No one at that point was anticipating the Trade Center's collapse, but within minutes the South Tower fell with an unearthly roar. A few seconds later, clouds of dust and debris were pushing their way through the narrow streets of New York's financial district. Many thought a bomb had exploded.



Along with thousands of others, I ran for the water while covering my mouth and shielding my eyes. At the East River, the dust clouds started to dissipate and I headed northward, picking up bits and pieces of information as I moved uptown.

Department offices closed for the next three days, but that didn't stop New York Insurance Department volunteers from helping in any way possible. On Monday, September 17, the Department's Manhattan office was once again open for business, a significant achievement given the obstacles that stood in our way.

In this issue, Scott Hoober looks at how the New York Department responded to September 11. It is must reading for those states rethinking their own disaster plans.

We are thankful that no Department personnel lost their lives that day, although many lost family and friends. Sadly, former New York Insurance Superintendent Neil Levin perished in the tragedy. Superintendent Levin left the Department earlier this year to head the Port Authority of New York and New Jersey, which was headquartered in the Twin Towers.

Our hearts go out to the victims and their families and we extend thanks to the brave firefighters, police officers and rescue workers who inspired us during our darkest hours. We are forever in your debt.

C.E. News

DID YOU MISS THE CONTINUING ED COMPLIANCE DEADLINE?

Designee holders who missed the October 1 deadline for reporting required continuing education credits during the annual compliance period, September 1, 2000 to September 1, 2001 will soon be receiving notices from the IRES CE Office that IRES will no longer recognize their designation.

To be automatically reinstated, designee holders must certify all past CE hours and pay a $60.00 reinstatement fee. Those who filed extensions prior to the deadline have one year to complete the required CE hours.

If insufficient CE hours were earned during the compliance period, a written appeal for reinstatement must be made in writing to the Accreditation & Ethics Committee in care of the IRES CE Office.

NEXT REPORTING DEADLINE IS OCT. 1, 2002

N · I · C · E

New York regulators grapple with WTC tragedy

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But the department also has a major presence in Albany. Much of its response shifted upstate, where the department's people were active in the State Emergency Management Organization (SEMO) command post, as well as their own IEOC.

Redundancy

"We created redundant offices in New York and Albany in anticipation of the dislocation of one or the other of the offices," Serio told *The Regulator*.

In testimony before the U.S. House Committee on Financial Services in late September, the superintendent elaborated: "The IEOC was activated within one hour of the disaster, and within 24 hours senior executives from 15 major insurance companies were seated in our war room in Albany.

"The team began compiling information from the insurance community across the state," he added. "In addition, the team facilitated the provision of claims estimates and the payment of claims as they were presented to individual companies. Videoconferencing and remote satellite video links from the field connected SEMO, the department's command center and the Office of the Director of State Operations within the governor's office."

The IEOC took calls from consumers too, using its own personnel as well as company reps to answer questions and collect feedback. Serio's people also passed along information via the department Web site, both to the general public and, via a password-protected area of the site, to insurers.

As in any catastrophe, the department got involved in issues large and small, including tracking the insured damage, dealing with the press, keeping tabs on its own and insurers' catastrophe teams and vehicles and arranging for temporary offices, including office space in Midtown and walk-in service centers at Pier 94 in Manhattan and three others out in the suburbs. The consumer centers were open 12 hours a day, seven days a week — and the department's fraud people worked the same demanding schedule.

When it came to issuing temporary licenses to the 125 adjusters who came in from out of state, the New York department outdid itself, issuing the licenses within an hour. Some of that efficiency came through use of the Web site.

Serio, who routinely divides his time between the Albany and New York offices, also reached out to major companies and brokers involved in the disaster, including Marsh USA and Aon, two of the nation's largest brokerages.

The view from the FDR Drive, on Manhattan's East Side, about 10:20 a.m. One tower had fallen and, in another 10 minutes, the other would crumble.

Though the firms had lost key employees in the collapse of the World Trade Center, "I was pleased that both companies' disaster-preparedness plans allowed them to continue operations," he said.

Serio and his people helped in a variety of ways, including assisting in finding office space for displaced insurers so they could meet consumers' needs. But their focus was on the long term as well.

"I had three objectives," the superintendent said. "First I wanted to open the lines of communications between the department and each impacted insurance

entity relating specifically to the disaster. Second, I wanted to determine the financial impact on each insurance entity and obtain a general sense of the ability of the industry to pay the expected claims. Finally, I wanted to have the opportunity to remind each individual company, and the industry collectively, of their obligation to the consumer and the expectation of the department that they would pay claims expeditiously and without raising non-applicable exclusions."

Anticipating disaster

Much of the department's work was behind the scenes. But in one specific, well-publicized move, life insurers were urged to use a standardized affidavit in lieu of a death certificate — greatly speeding up payment to bereaved survivors.

"That's a perfect example of how both the government, which has to to authorize this, works right along with the city and the insurance industry to make sure that these people get their money as quickly as possible," said Robert Hartwig, vice president and senior economist with the Insurance Information Institute.

"For insurers, that's a claims-handling homerun," he added. "I mean, technically, under the law, the insurers could have waited three years."

The circular letter on proof of death was one of six the department issued in the aftermath of the disaster.

Hartwig pointed out that an event of this magnitude is impossible to fully plan for, but state regulators can still come through after the fact to meet consumers' and companies' needs.

"Clearly there's nothing state insurance regulators could have done to prevent this," he said.

"Yet in some sense their job was done beforehand: It seems as though insurers were appropriately capitalized, so we don't see a rash of insolvencies — at least not immediately. So far, so good."

I wanted to have the opportunity to remind each individual company, and the industry collectively, of their obligation to the consumer and the expectation of the department that they would pay claims expeditiously and without raising non-applicable exclusions.

— New York Insurance Supt. Gregory V. Serio

By some measures, the Sept. 11 attack wasn't the largest catastrophe ever to hit the U.S. In 1992, following Hurricane Andrew, fully 17,000 adjusters converged on south Florida, ultimately settling 700,000 claims. The number of claims in lower Manhattan is likely to be only a fraction of that. But since they'll be mostly largely commercial claims, rather than individual homes, apartments and small businesses, as in a hurricane or other natural catastrophe, the total insurance payout is likely to be at least twice as large as it was following Andrew.

On top of that, while Hurricane Andrew certainly captured the attention of the media, the Sept. 11 attack occurred next door to Wall Street — and down the street from the headquarters of the major broadcast networks and the nation's business press.

The Wall Street Journal may have moved its newsroom across the river to New Jersey after the tragedy, but there was no reduction in its reporters' day-to-day scrutiny of state government's role in the recovery.

The department has already begun to scrutinize itself, reviewing how well its disaster plan worked in the real world. Even though everything didn't go perfectly, the idea isn't to criticize anyone, Serio said. Even when things go perfectly, he said, "you can always nuance or tweak your system" to see that it works still better next time.

Human reaction

Beyond doing their regular jobs, department employees also had to deal with their own emotions — beginning with the death of Neil Levin, Serio's predecessor, who had been appointed executive

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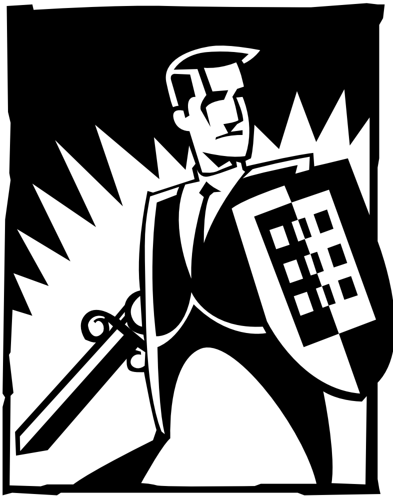

Does one of your co-workers deserve special recognition?

The Al Greer Award annually honors an insurance regulator who not only embodies the dedication, knowledge and tenacity of a professional regulator, but exceeds those standards. If you have someone you'd like to nominate, it's easy. Contact the IRES office (913-768-4700 or ireshq@swbell.net) and request a nomination form. Or visit our web site at **www.go-ires.org**

AL GREER ACHIEVEMENT AWARD

Insurance Regulatory Examiners Society

Serio praises the WTC response by New York regulators

continued from previous page

director of the Port Authority of New York and New Jersey not long before.

After the disaster, after the office was hurriedly evacuated, department officials contacted every employee, either by phone or in person. A number of people headed for the Operations Center in Albany.

The Department decided it would be appropriate to get its headquarters back in operation on Sept. 17, the same day the New York Stock Exchange planned to be back in business. Though attendance was voluntary, a great many department people came to work that day — walking through dust and debris, past National Guardsmen in uniform. For the first few days, the building was still filled with the smell of the dust that had covered everything in the vicinity of Ground Zero.

"While the date and horrors associated with Sept. 11 will be forever etched in our minds," Serio said, "the department will also remember another date — Sept. 17. It was on Sept. 17, less than one week after the disaster, that the department opened its Manhattan office.

"On that day, more than half of the department staff voluntarily reported to work."

Despite horrendous commutes and all the disruption in the streets leading up to their building, staffers showed up, ready to work.

"We were the first agency to be back in our offices," said Serio.

"Our staff managed all those challenges with real dignity and real strength," he added. "They were heroic."

Compensation Fund Established for 9/11 Victims

A remarkable Victim Compensation Fund was enacted into law on September 22 as part of the "Airline Transportation Safety and System Stabilization Act" (Public Law 197-42; H.R. 2926).Remarkable in that the new law allows eligible claimants to collect both economic and noneconomic (pain and suffering) damages from the federal government.

There are no caps on compensation, but benefits will be reduced by any collateral sources of compensation — such as life insurance payments, pension benefits, and other government benefits. The big advantage is speed. Claimants should have a check in their hands no later than five months after filing their claims.

By assuming liability for economic losses, the government could be putting itself on the hook for significant sums to compensate the families of the many high-earning victims who perished on September 11. The fact is that nobody currently knows the extent of the collateral sources of income for these claimants, but our best guess is they will fall far short of matching a lifetime of high earnings.

Compensation decisions will be rendered through a Special Master who will be appointed by the United States Attorney General, who in turn will hire special hearing officers to pass judgment on thousands of anticipated cases. Hearing officers will not consider negligence of any third parties, but rather will base their decisions on harm to the claimant, the facts of the claim and the individual circumstances of the claimant.

Claimants who file for compensation must give up their right to sue third parties (except to recover collateral source obligations). For many, the trade-off will be worth it since determining liability is likely to be a long and arduous process, with little legal precedent. Moreover, the airlines' ultimate liability is capped under this new legislation, and many other third parties will not be in a position to pay any court-ordered judgments.

Provisions of the new Victim Compensation Fund include:

♦ No more than one claim per victim can be submitted for compensation.

♦ Claimants may be represented by an attorney and may present evidence.

♦ All decisions of the Special Master are final and *not* subject to judicial review.

♦ The fund will pay no punitive damages.

♦ Claimants have two years from the date regulations are issued to file for compensation.

♦ Compensation determinations will be made within 120 days of filing a claim.

♦ Following a compensation determination, the fund has up to 20 days to authorize payment.

♦ The U.S. government retains subrogation rights to any claim paid by the fund.

Ultimately, claimants will have to decide whether they trust the new system to provide a fair and equitable settlement. They must also weigh whether the assurance of a timely compensation package without regard to third-party liability is preferable to a long, potentially fruitless quest for a larger settlement. ■

Are insurers prepared for the mental health fallout from Sept. 11?

By Vicki Lankarge
insure.com

Throw out all the studies on the psychological effects of a national disaster that were conducted prior to Sept. 11, 2001, says child psychiatrist Dr. Barry Herman, an executive board member of the National Coalition for Mental Health Professionals and Consumers. "Get braced for the unknowable," says Herman. "Mental health professionals, especially those who work with children, should be prepared to deal with an epidemic of significant stress reactions."

Health insurers are already noticing an increase in the number of requests they normally receive for mental health services, particularly in New York and New Jersey, according to Erin Somers, a spokesperson for Magellan Health Services, a managed behavioral health care company. In response, companies like Magellan have made their employee assistance counseling and "critical incident" stress management programs available to help its employees and their families deal with the terrorist attacks.

But are insurers *really* prepared for the mental health fallout from Sept. 11? Karen Shore, the founder and past president of the National Coalition for Mental Health Professionals and Consumers, doesn't believe so.

"People had a hard time getting mental health treatment *before* Sept. 11," she says. With its phantom networks (HMO networks that lists doctors who are not taking new patients) and treatment limits, Shore says "the managed care system is an affront to mental health patients" and one that the terrorist attacks are not likely to change any time soon.

But health plans are sensitive to the criticisms being leveled at them, says Leslie Moran, the spokesperson for the New York Health Plan Association. "Health plans are extremely sensitive to the needs of the public right now," she says. "They're making an extra effort to avoid making it difficult for their members who need help."

Nation raped

According to Herman, there is no precedence for this kind of disaster — which is precisely why it's impossible to predict how the psychological aftershocks may evolve. "Time is usually a healer," he says, "but if more bombs go off, it will just revivify the experience."

Herman says that following the attacks, people exhibited some of the same reactions as victims of rape, including hypervigilance (increased awareness of one's surroundings), depression, and sleeplessness.

"It's the classic rape response," says Herman. "This was the rape of our country."

According to Dr. Robin Dea, chairman of the chiefs of psychiatry for Northern California Kaiser Permanente, the attacks were certainly a personal violation to Americans' sense of security and safety. "We have been violated in the same way that we were violated at Pearl Harbor, or when John F. Kennedy was assassinated," she says. "It was the very shock of it happening on our own soil."

The initial numbers have been sobering. Shore says an estimated 15,000 children have lost one or

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both parents in the attacks. And according to the Pew Charitable Trust, a nonprofit public policy philanthropy, in the wake of the terrorist attacks:

- Seven out 10 Americans have felt depressed.
- Nearly one in two have had trouble concentrating.
- One in three have had difficulty sleeping.
- One-fifth knew someone who was killed, injured or is still missing from the attacks, or have a friend or relative who does.

Make no mistake about it, says Shore, “there will be more substance abuse, gambling, and other addictive behaviors as people try to anesthetize the pain. In particular, people in New York City are still going to funerals — sometimes dozens of them. You can’t keep doing that and not be affected.”

Many health insurers, particularly those in New York and New Jersey, have responded by loosening treatment caps. According to Moran, Oxford Health Plan has extended by 10 the number of mental health visits a member may make by Dec. 31, 2001.

But Shore says she is concerned about the long term. “There is a great outpouring of people offering free services right now, but people are still in shock,” she says. “What happens down the road? We’re still seeing Vietnam vets coming into VA hospitals for the very first time to get treatment for post-traumatic stress disorder. It’s, what — 35 or 40 years later?”

Reaction so far

In the wake of the terrorist attacks, Dea did a quick survey of five of Kaiser Permanente’s behavioral health care facilities in Northern California. She says the facilities all reported receiving an increase in the number of telephone calls from their members who work in the financial services and airline industry. “There were also reports that existing patients would call and, before they could address whatever was the usual topic of conversation, they would want to tell the therapist what effect the tragedy was having on them. A lot of it was, ‘I was generally stable, but this thing has really thrown me for a loop.’”

Dea says that the first week after the attack the volume of calls coming in was “barely a trickle.” She says it picked up the second week, but “quieted down again” by the third week. According to Dea, Kaiser held mental health help meetings two or three times a week after the Bay Bridge earthquake in 1989 and had planned to do the same after this disaster, “but the demand hasn’t been there this time.” Dea says she believes people are using other outlets for talking about their concerns, such as friends, employee assistance programs, or clergy.

“As a culture, we’re already seeing things getting back to normal,” Dea says, particularly for those who live outside the areas that were attacked. “We’re already seeing airplane traffic pick up.”

Dea says people should take comfort in knowing their emotional reactions to the tragedy are shared by many others and are, for the most part, what mental health experts would expect. “For the first three to five days, everyone was numb,” she says. “Then we were all glued to our TVs. It was all we talked about. By the third week, we were saying, ‘I have to get away from this. I have to get out, go to a movie.’”

Dea suggests that if you aren’t one of the people who lost a loved one or know someone who did and “you’re still feeling numb, it might be worthwhile to have a [mental health] evaluation.”

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And remember: The Regulator newsletter is free to all IRES members.

Regulators: Be Aware of these Emerging Issues

In addition to the impact September 11 had on insurer financial solvency, liquidity and pricing, regulators are scrambling to deal with a number of other emerging issues, such as:

- **No Terrorism Reinsurance:** Until an alternative mechanism to reinsurance becomes available to spread the risk of terrorism, insurers will be compelled to reevaluate their "acts of war" exclusion and take a fresh look at introducing an "act of terrorism" exclusion. This has implications for both the policy form approval process and rate reviews.

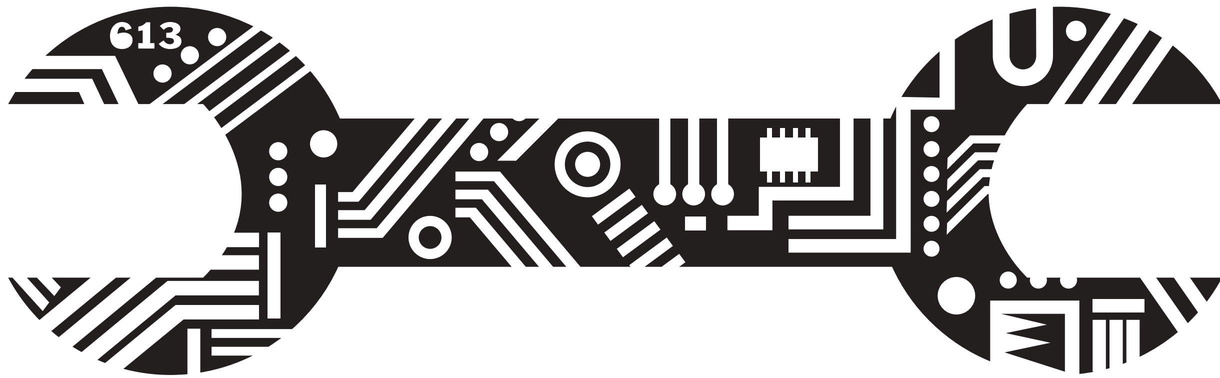
- **Business Interruption Insurance:** Business owners frequently are unaware of the scope and limitations of their business interruption and civil authority coverages. Insurance departments may be receiving complaints and questions about this complex coverage and regulators may need to reevaluate the policies and endorsements approved for this line.

- **Fraud:** Fraudulent property/casualty and life claims are likely to arise from the Sept. 11th tragedy. Thus far, insurers have responded well to the needs of policyholders affected by the tragedy, but they must not let down their guard with respect to fraud.

- **Mental Health Usage:** Health insurers, already strained prior to September 11, may see mental health claims rising as a result of the tragedy, with an attendant jump in complaints (see article, p. 8).

- **Cipro Evaluations:** What are the public policy implications if health insurers begin evaluating the medical necessity of prescriptions for Cipro and other Anthrax treatments, including emergency room visits? What is the impact on net income and pricing if they do not?

- **Disaster Plans:** Insurance departments need to reevaluate their disaster plans, especially their duplication-of-records standards, their ability to locate and redeploy staff, and their capacity to maintain operations in the event their center of operations becomes inhabitable.



‘Risk-focused’ exams: Choosing the right tool

by Frances J. O’Connor

In 1994, the National Association of Insurance Commissioners (NAIC) adopted the current version of the *Financial Condition Examiners Handbook (Handbook)* which delineates criteria and standards to increase the efficiency and effectiveness of the examination process.

Our present system embodies a risk-based approach to identify those insurers most likely to experience actual or potential problems. The *Handbook* outlines procedures to schedule, plan and conduct an examination upon determination of the appropriate scope, which is based on audit risk, and focuses on the verification and accuracy of reported information.

After an insurer had been selected for examination, a risk analysis methodology is utilized to focus on the combined impact of the environment in which the company operates, its financial condition and operating results, and the extent and effectiveness of its internal control structure.

The methodology was developed to enable the examination team to tailor an examination program to an insurer’s unique circumstances and incorporate the most effective method and degree of substantive testing to verify reported information and compliance with state law.

Trends Driving Regulatory Change

In response to rapid changes in technology, legislative, and global market pressures as well as consolidation in the financial services industry, many financial regulators have introduced a “risk-focused” approach to supervision.

The risk-focused approach has been adopted by banking regulators in the U.S. and other countries. In 1997, the Basel Committee on Banking Supervision, an international association of banking supervisors, released its Core Principles for Banking Supervision which were predicated on the concept that banking by its nature, entails taking a wide variety of risks.

Banking supervisors must understand those risks to be satisfied that banks are adequately measuring and managing them. The Basel Committee has subsequently issued guidance describing best practices for bank management of various risks.

Frances J. O’Connor is Director of Federal & International Relations for the Connecticut Insurance Department. She has served on various NAIC financial and special issues committees and working groups. She is responsible for coordinating the implementation of the provisions of the Gramm-Leach-Bliley Act that impact insurance regulation and establishing relationships with other federal and international regulatory agencies to promote information sharing and cooperation in the oversight of financial services conglomerates.

In addition to banking supervisors, insurance regulators around the world are adopting a risk-focused approach to supervision. Examples can be found in the UK, Canada, Australia, and Sweden, among other countries. The Core Principles for Insurance Supervision, developed by the International Association of Insurance Supervisors (IAIS), support regulatory processes that ensure the prudent management and control of risk concentrations by insurers.

Many financial service firms in the US and abroad are assessing the need to restructure their business strategies. A well-run organization should be aware of its potential entity-wide risk exposure, develop risk management systems and institute controls by business segment, and incorporate the segment information into a corporate plan.

A risk management plan outlines the organization's approach, provides measurement through analytical tools of the risk inherent in the business and the products it offers in all segments and incorporates controls to manage risk. Risk management is an integral part of the organization's capital allocation process.

As the insurance industry changes, the regulatory environment must evolve to meet the challenges of the new economic environment.

Traditionally, the US insurance market developed from state to state reflecting differences in demographics and geography. Today, the structure and operations of the insurance industry are changing because of competition and convergence in the financial services industry. The complexity and blending of new products and the speed at which they are introduced have dramatically increased as insurers compete with other sectors of the financial services industry. As the insurance industry changes, the regulatory environment must evolve to meet the challenges of the new economic environment.

Adopting a bank-like process?

Banking regulators have been utilizing a dynamic, risk-focused approach in the "safety and soundness" supervision of the financial institutions under their jurisdiction since the late-1990s. The intent of the safety and soundness concept is to ensure the safe and sound operation of bank holding companies, and their banking and non-banking subsidiaries, for the protection of the depositories, the insurance fund and ultimately, the bank's depositors. Banking examination and analyses functions focus on the quantitative and qualitative evaluation of risk to assess the financial condition of the institution.

Banking examination procedures place a great deal of emphasis on front-end supervision, with off-site analysis playing a significant role in the continuous monitoring process. The risk assessment function is critical to banking regulators' analyses and examinations. Key risks are measured across business areas in the bank.

The assessment of these risks frames the scope of the on-site examination. Examinations include a review organization structure, corporate governance and risk management practices, meetings with management and staff, follow-up on findings from prior reviews, leveraging work performed by internal audit/control functions, conducting transaction testing to the extent deemed appropriate and developing a preliminary rating and report.

Banking examination reports are considered confidential. They contain conclusions relating to the functional area under review, communication of the examiner's assessment of the internal risk-management system, the institution's financial condition, compliance with laws and regulations as well as any supervisory issues, problems or concerns. The report also contains a rating that reflects the adequacy of the institution's risk-management systems and capital adequacy in light of the amount and types of risks it has assumed. The final report is often presented to the institution's board of directors by the banking supervisors. Like insurance regulators, banking supervisors have various levels of supervisory action for regulatory intervention.

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Risk-focused exams: Tools for the next generation

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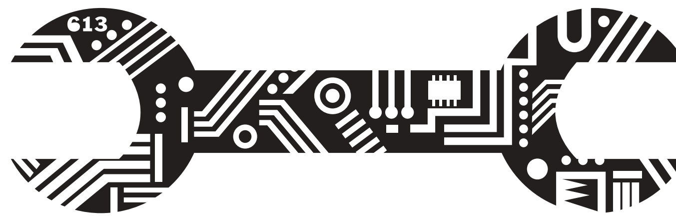
Under banking regulation, on-site examinations are more frequent. Examination reports are more timely and therefore more useful in addressing deficiencies. Confidentiality permits a more open exchange between the supervisor and institution. Capital adequacy measurement is an outcome of risk assessment — better risk assessment could enhance risk-based capital standards.

Risk-focused solvency regulation

The intent of the risk-focused approach is to formalize a dynamic, prospective structure for evaluating the risk inherent in an insurer's operations. The nature of risk is unique to each company depending on its product mix and investment strategy. Types of risk and their significance vary by activity. Investment activities involve credit risk, market risk, and liquidity risk. In product sales, insurers may assume catastrophe risk, market risk, or liquidity risk in varying degrees depending on the product.



Over the years, insurance regulators have developed numerous tools that address the risks insurers assume. Investment laws implicitly limit the market and credit risk insurers can hold. Limitations on net retentions address catastrophe risk. Risk-based capital requirements establish capital levels recognizing a variety of risks.

The basis of our current framework of solvency regulation is retrospective. Our current financial tools focus on static risk and are qualitative in nature. The analysis of financial statements and other information is performed as of a point in time for the early detection of potential problems. Environmental risk and trends that may effect the insurer's financial condition are considered in the analysis process, but the approach does contain formal, systematic procedures for evaluating the risk inherent in the insurer's operations, or the impact it might have on the company's future viability.

Our current examination approach is risk-based but focuses on the verification of the completeness and accuracy of the insurer's annual statement data prepared in accordance with the state's prescribed or permitted accounting practices, and validation that the insurer is in substantial compliance with the state's insurance code.

To meet the challenges brought on by financial modernization, globalization and convergence in the financial services industry, the NAIC's Risk Assessment Working Group (RAWG) is developing enhancements to our current financial analysis and examination procedures.

These new solvency tools will incorporate a systematic approach to evaluate risk exposures including strategies to manage risk, and focus on the qualitative aspects of an insurer's operating environment and management. These procedures are intended to supplement the review of financial position, performance, operations, management and corporate governance. These new tools will provide prospective insight and give insurance regulators the necessary information to completely assess the stability and viability of the insurer's operations.

The enhancements include a formal system for identifying risk, processes for documenting the results of the analysis, and recommendations on how the analytical review should be integrated into the financial monitoring process.

In conjunction with this effort, RAWG will encourage more effective use of the risk-based examination approach currently found in the *Handbook* with respect to procedures intended to focus examination resources on critical areas and to make effective use of other resources. This includes, reliance on CPA workpapers where appropriate, and limiting testing in areas where the likelihood of a material misstatement is low. RAWG will also

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Risk-focused exams

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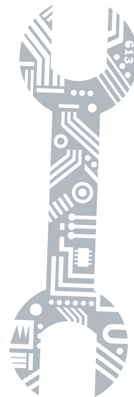
recommend that these procedures be implemented consistently by the states.

Where are we today?

The *Handbook* calls for the identification of risk during the pre-examination review and placing reliance on internal controls in the planning phase. The critical difference is that the bank supervisors' approach is to assess risk; whereas the insurance regulator's assessment of risk is used to gauge the amount of substantive testing to be performed during the examination, with the primary goal being verification of the balance sheet and secondarily, compliance with state laws.

Several states, including Connecticut, Ohio and New York, are considering the risk-focused approach to exams. They are incorporating elements of risk assessment in their solvency monitoring processes, including the pre-exam review and planning phase to determine the scope of the exam. This allows resources to concentrate on high-risk areas where there is a likelihood of material misstatement that would affect the company's financial position.



Both Connecticut and New York have worked with the Federal Reserve as "functional regulators" of the insurance subsidiaries of a special type of bank holding company referred to as a financial holding company.

Although insurance and banking are different industries, there are many common elements in the banking risk-focused regulatory approach that are portable. Risk management is evolving in scope and in practice in the financial services sector as a means for increasingly complex business organizations to manage their operations.

State oversight of financial solvency has had a good track record, but we must enhance our processes to include risk assessment to keep pace with changes in today's business environment and to be consistent with the dynamic, prospective approach used by other financial regulators. ■

IRES Foundation accepting nominations for Paul DeAngelo teaching award

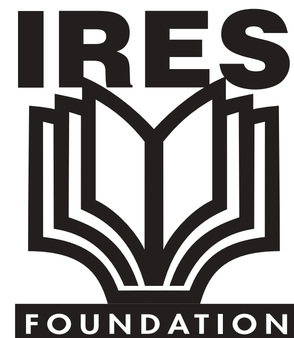
Nominations due Dec. 1, 2001

The IRES Foundation Board of Directors has established the Paul L. DeAngelo Memorial Teaching Award for persons who have made major contributions to the education of insurance regulators, consumers and insurers.

The award will bring with it a $1,000 scholarship for attending insurance educational programs. The program is named in honor of the late Paul DeAngelo, New Jersey insurance regulator, who died last year.

Nominees can be a current or former regulator with at least five years of regulatory experience, and must have participated as an instructor at educational programs sponsored by IRES, the IRES Foundation or the NAIC.

Other nomination details can be obtained by requesting a Paul L. DeAngelo Award nomination form from the IRES office in Olathe, Kan., 913-768-4700, ireshq@swbell.net. The form can also be found on the Foundation's web site, **www.ires-foundation.org**



Quote of the Month

"In 1860, the original seal of the New York State Insurance Department — 'Alter Alterius Onera Portate' or 'Bear ye one another's Burdens' — eloquently expressed the fundamental public interest that is the very essence of insurance. At no time in the history of this country has that phrase been more important, or reassuring."

— New York Superintendent of Insurance Gregory V. Serio, in testimony before the U.S. House Committee on Financial Services, 9/26/01

The Signs of Excellence

REGULATORY ROUNDUP

By
Stroock & Stroock
& Lavan LLP

California Law Takes Effect Mandating New Disclosure Requirements for Life Agents. On July 1, 2001, Chapter 442 of the Laws of 2000 (Chapter 442) became effective, mandating new disclosure requirements for life agents offering or selling financial products to senior citizens. The purpose of the legislation is to ensure that senior citizens purchasing financial products will be informed of their options and the effects such purchases will have on their finances and the treatment of the products under the California Medicaid program (Medi-Cal).

Chapter 442 provides that if a life agent offers to sell to a senior citizen any life insurance or annuity product, the life agent must advise the senior citizen or their representative in writing that the sale or liquidation of any stock, bond, IRA, certificate of deposit, mutual fund, annuity, or other asset to fund the purchase of the product may have tax consequences, early withdrawal penalties, or other costs or penalties as a result of the sale or liquidation. The life agent is also required to inform the senior citizen or their representative that he or she may wish to consult independent legal or financial advice before selling or liquidating any assets prior to the purchase of life or annuity products. The law does not apply to credit life insurance products.

If a life agent offers a financial product to a senior citizen on the basis of the product's treatment under the Medi-Cal program, then the life agent who offers or sells the financial product is required to provide a disclosure form to the senior citizen or their representative. The California Department of Insurance is promulgating regulations to implement Chapter 442. It is expected that the regulations will prescribe the standard disclosure form required by the law. **www.insurance.ca.gov.**

The New York-based Stroock & Stroock & Lavan LLP Insurance Regulatory/Corporate Practice Group includes Donald D. Gabay, Martin Minkowitz, William D. Latza, and Vincent Laurenzano, an insurance finance consultant. They gratefully acknowledge the assistance of Robert Schmidlin, an associate with the Group. This column is intended for informational purposes only and does not constitute legal advice.

Illinois Producer Licensing Bill Signed. House Bill 2994 was signed into law on August 16, 2001, bringing Illinois into compliance with the producer licensing requirements of the federal Gramm-Leach-Bliley Act (GLBA). House Bill 2994 is now Public Law 92-0386.

GLBA requires a minimum of 29 states to enact, by November of 2002, either uniform agent licensing laws and regulations or reciprocity laws and regulations governing the licensure of nonresident agents or be subject to national licensing standards established by a National Association of Registered Agents and Brokers (NARAB). With the enactment of Public Law 92-0386, Illinois became the 36th state to enact legislation in compliance with the GLBA producer licensing requirements.

The key provisions of the Illinois law include: revising Illinois' producer licensing law to conform with the NAICs' model regarding definitions, exceptions to licensing, termination notifications, and reciprocity provisions; providing reciprocity in the licensure of nonresidents by permitting them to obtain an Illinois license if they are currently licensed in good standing as a resident in their own state, have paid the required fees for licensure in Illinois, and have provided Illinois with a copy of their home state license application; exempting persons who are currently licensed in another state from having to take an Illinois examination and meeting pre-licensing education requirements; and authorizing the Director of the Department of Insurance to waive requirements for nonresident license applicants who have a valid license from their home state if their home state awards nonresident licenses to Illinois residents.

Public Law 92-0386 also requires that a surplus line producer complete a prelicensing course of study in lieu of passing a written examination; provides that the submission of insurance contract information by surplus line producers and the countersignature by the

Surplus Line Association of Illinois may be performed electronically; and requires that each surplus line producer must maintain electronic or paper copies of surplus line insurance contracts and require that such contracts be available for inspection by the Director and the Surplus Line Association of Illinois.

Public Law 92-0386 becomes effective January 1, 2002. **www.state.il.us/ins/.**

Court Holds That The Louisiana Insurance Department May Not Seek Judicial Review Of An Adverse Administrative Decision. The Court of Appeal of Louisiana held recently that the Louisiana Insurance Department did not have a state constitutional right to seek judicial review of an adverse administrative decision. The case arose from an administrative law judge's ("ALJ") 1998 decision ordering the Department to approve a "Rental Condominium Unit Owner's Policy" form submitted by State Farm. The Commissioner of Insurance filed for judicial review with the District Court and the case ensued.

In 1999, State Farm filed a peremptory exception of no right of action claiming that the Department, a state agency, was precluded from pursuing judicial review under the provisions of the Louisiana Administrative Procedure Act (LAPA) or the Division of Administrative Law. The trial court entered a judgment sustaining the exception, and dismissed the Commissioner's petition for judicial review. The Commissioner appealed, asserting that the trial judge erred in ruling that the Commissioner of Insurance did not have standing to seek judicial review of the decision rendered by the Division of Administrative Law. The Commissioner argued that the Department, as a "person" under Louisiana law, had a constitutional right to seek judicial review of an adverse decision rendered by an ALJ.

The Court stated that while the Department was by law a "person," it was a juridical person as opposed to a natural person, and who had no more legal capacity than allowed by law. The Court then considered whether the LAPA permitted the Department to have a constitutional right to judicial review as a juridical person.

The Court cited the section of the LAPA that precludes state agencies from seeking judicial review of adverse administrative decisions, but noted the LAPA did provide a constitutionally adequate remedy by allowing the Department to argue its position before an ALJ. Such was the intent of the Legislature, which, as evidenced by passage of the LAPA, chose to deny state agencies any entitlement to judicial review. The Court then affirmed the trial court's decision to dismiss the Commissioner's petition. See *Brown v. State Farm Fire & Casualty Company*, 2001 WL 700385.

New Jersey Health Plan Liability Legislation Becomes Law. On July 30, 2001, Senate bill S.1333 was signed into law, and became Chapter 187 of the Laws of 2001.

Known as the "Health Care Carrier Accountability Act", the law allows persons covered under a health or dental benefit plan issued by an insurance company, health, hospital or medical service corporation, health maintenance organization, dental plan organization or dental service corporation (the carrier) to sue their carrier or an organized delivery system for economic and non-economic loss that occurs as a result of the carrier's or organized delivery system's negligence with respect to the denial of or delay in approving or providing medically necessary services covered by the carrier. Under New Jersey law, an "organized delivery system" may contract with a carrier to provide, or arrange to provide, under its own management, substantially all or a substantial portion of the comprehensive health care services or benefits under the carrier's benefits plan on behalf of the carrier, which may include the payment of hospital and ancillary benefits provided by the carrier.

The carrier or organized delivery system is liable to a person covered by the carrier when the denial or delay is the proximate cause of a person's: death; serious and protracted or permanent impairment of a bodily function or system; loss of a body organ necessary for normal bodily function; loss of a body member; exacerbation of a serious or life-threatening disease or condition; a physical condition resulting in chronic and significant pain; or substantial physical or mental harm which resulted in further substantial medical treatment made medically necessary by the denial or delay of care.

Any person bringing an action against a carrier or organized delivery system is required to first exhaust

REGULATORY ROUNDUP

continued from previous page

their right to an independent external review of medical services, unless serious or significant harm to the person has occurred or will imminently occur. “Serious or significant harm” is defined to mean: “death, serious and protracted or permanent impairment of a bodily function or system, loss of a body organ necessary for normal bodily function, loss of a body member, or exacerbation of a serious or life-threatening disease or condition that results in serious or significant harm or requires substantial medical treatment.”

The law will go into effect on November 1, 2001. **www.njleg.state.nj.us.**

Tennessee Enacts Major Anti-Fraud Legislation. On July 1, 2001, Chapter 356 of the Laws of 2001 became effective, enacting new provisions to combat insurance fraud in Tennessee.Prior to the enactment of Chapter 356, Tennessee law prohibited the making of false insurance claims and punished the offense as if it were theft.

Chapter 356 prohibits the following conduct when done knowingly, with intent to defraud, and for the purpose of taking another person’s property or for financial gain, or with the intent of causing reliance thereon: (1) presenting information containing false representations of material fact or concealing a material fact regarding the following in connection with an insurance transaction: (a) an application for, rating of, or renewal of an insurance policy; (b) a claim against an insurance policy; (c) payments made pursuant to a policy; (d) an application used in a premium finance transaction; (e) solicitation for sale of a policy; (f) an application for a certificate of authority; (g) the financial condition of an insurer; or (h) the purchase, formation, merger, affiliation, or dissolution of an insurer; (2) soliciting or accepting new insureds for an insolvent insurer; (3) removing assets or records from an insurer’s home office or hiding the documents or assets from the department of commerce and insurance; or (4) misappropriating or embezzling insurance funds.

Chapter 356 also requires the notification of the appropriate licensing board if any health care provider, lawyer, or insurance-related licensee is convicted of an unlawful insurance act. Any licensee convicted of an unlawful insurance act may have their license revoked.

Chapter 356 authorizes the Attorney General to prosecute cases on behalf of the Tennessee Insurance Department and insurance fraud victims. A court that convicts a person of an unlawful insurance act can order the offender to pay restitution, in addition to being subjected to criminal penalties. Violators may also be subject to civil actions by insurance fraud victims.

Insurers are required to produce information related to suspected insurance fraud to law enforcement upon request, subject to legal privilege. Insurers are required to develop anti-fraud plans and submit the plans to the Department. An insurer would also be required to place fraud warnings on claim forms. Chapter 356 subjects an insurer that fails to make an anti-fraud plan to a civil penalty of $500 per day up to $25,000. **www.legislature.state.tn.us**

Planning Ahead

- April 7-9, 2002 National Insurance School on Market Regulation. Sponsored by IRES Foundation. Sheraton on San Diego Bay
- 2002 – IRES CDS. San Antonio. July 28-30 Hyatt Regency
- 2003 — IRES CDS. Scottsdale, Ariz. Hyatt Gainey Ranch

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— Kara Navarro, partner, Sonnenschein, Nath & Rosenthal, San Francisco

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In this issue:
Remembering
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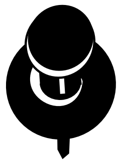

BULLETIN BOARD

√ **Attention — those members working toward your AIE designation!!** Beginning Sept. 1, 2002, IRES will institute its all-new Life-Health Path options for those studying to be an Accredited Insurance Examiner. This new curriculum will, for the first time, allow life-health regulators to choose a path that stresses either life insurance or health insurance. (Applicants presently can choose either a life-health curriculum or a property-casualty curriculum.)

Under the new plan, all AIE candidates taking the Life/Health curriculum will be required to take four "core" courses: FLMI 280, FLMI 290, AIRC 410 and AIRC 420. The remaining four courses needed to complete the AIE requirement can then be chosen from two separate options — the Life Option or the Health Option.

Courses under the Life Option are; FLMI 310, FLMI 320, FLMI 330, FLMI 340, and FLMI 361. Courses under the Health Option are: ICA C1 or ICA C3, AHM 250, AHM 510, and AHM 530. Combining courses from both options will not be acceptable for the purposes of meeting the designation requirement.

Members wanting a full, printed copy of the new curriculum should contact the IRES office at 913-768-4700 or ireshq@swbell.net

Welcome, new IRES members!

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Ann M. Lyon, DE
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How mold is affecting U.S. insurers