

# The Regulator<sup>®</sup>

INSURANCE REGULATORY EXAMINERS SOCIETY

*Commissioners interview*

## Listening to 'voices in the wilderness'

**EDITOR'S NOTE:** *Following the Commissioner's Roundtable at the recent IRES CDS in Tampa, Regulator Editor Wayne Cotter and Scott Hooper conducted a wide-ranging interview with NAIC President and Pennsylvania Insurance Commissioner **Diane Koken**, longtime Mississippi Commissioner **George Dale**, and Alabama's Commissioner, **Walter Bell**. Please note that this interview was conducted prior to Hurricane Katrina.*

**Regulator:** *Would something like the National Flood Insurance Program work for hurricanes?*

**Commissioner Dale:** It probably would . . . Flood insurance has been successful, but we've got to address disasters. Those of us who are in disaster-prone states, particularly people living next to the water . . . if we cannot find a mechanism to get them insurance, then economic growth will stop. That's a major problem.

**Commissioner Bell:** Twenty to thirty years ago on the Gulf [of Mexico] what you had was single family dwellings . . . Today we have a different situation. There are building codes today that can withstand 140 mph wind. A hurricane is a strange kind of animal because it comes in on the coast and that's where the peak of the wind is. So you don't have to have the same kind of building code 100 miles in as you have on the coast. But the coastline has to be so strong in terms of building codes. But 30 miles in, that 140 miles per hour wind is probably down to 100-110 miles per hour, so it's not going to do the same kind of damage . . .

**Dale:** If another [Hurricane] Camille hit the Gulf Coast with the development that is there now, there would be poker chips scattered from Biloxi to Pascagoula . . . because the law says casinos must be on navigable bodies of water . . . Will they withstand a storm? We don't know.

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**Who won the 2005 Publications Award? And why was he wearing a sack over his face? Only those who attended the Career Development Seminar in Tampa last month know the answers. See our coverage beginning page 10.**

## King elected new IRES president

TAMPA — Stephen E. King was elected 2005-06 President of IRES during the Society's annual meeting and Career Development Seminar at the Tampa Marriott Waterside hotel.

Also elected to the IRES Executive Committee at the annual meeting:

**President-Elect** — Douglas A. Freeman, CIE, Missouri

**Vice President** — Jo A. LeDuc, CIE, Wisconsin



**Treasurer** — Karen L. Dyke, CIE, Nebraska

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**Stephen E. King** **At Large** —

Katie Johnson, AIE, Virginia

**Past President** — Kirk R. Yeager, CIE, unaffiliated.

King is an unaffiliated, independent market conduct examiner from Salem, Virginia. He has been an IRES member since 1987, has been a longtime member of the IRES Board of Directors and holds the CIE designation. His IRES leadership

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# The Regulator®

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THE REGULATOR is published every other month by the



INSURANCE REGULATORY  
EXAMINERS SOCIETY

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## From the President

### Looking to the Future

As I work through the month after the CDS, I believe it is fitting to again congratulate Kirk Yeager on a very successful year as IRES president. This past year, all of us who have worked with Kirk, have benefited from his regulatory insight and leadership.



I have elected to share the gist of my remarks from our CDS in Tampa on August 2<sup>nd</sup>. To some of you, this will be a re-run, (for that I apologize) but I believe the message bears repeating so we'll all be on "the same sheet of music" as we move into 2006.

First and foremost, I believe that we have a strong organization that is moving in the right direction. That isn't to say, however, that we don't have some work to do. As with any organization, it is imperative that we continue to build upon the positives and fix, or at least, minimize the negatives.

1) As an organization, especially in these trying times, we must react to current changes and, at the same time, plan 3 - 5 years out and anticipate how we will deal with potential issues that will undoubtedly affect this organization.

2) We must develop new strategies to increase our membership base. That may involve renewed efforts with state insurance departments and/or new efforts dealing with other state or federal agencies.

3) We must do a better job of spreading the "good word" about IRES and continue our work to identify, develop and recognize our State Chairs for the fine job they are doing. They are the eyes and ears of this organization.

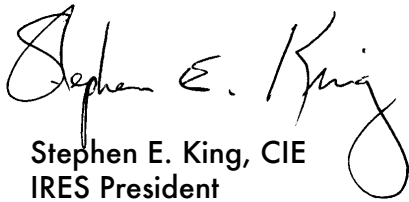
4) We must continue our close relationship with the IRES Foundation for they offer financial support and encouragement, as we continue to work on and develop educational initiatives. Furthermore, we must move forward with the MC+ Program (market conduct certification program). Implementation of

this certification program is so important, as we deal with current market conduct and market regulation initiatives.

5) We must continue to strengthen our working relationship with the NAIC. By coordinating efforts in dealing with a variety of regulatory issues we become a stronger, more viable organization.

6) Lastly, but perhaps the most important issue of all . . . we must get more active involvement from our membership. We need the youth and the new ideas they can "bring to the table." If you like what you saw at the Tampa CDS, get involved; be a part of it. If you don't like what you have seen, get involved, change it and make it better. Please don't sit back and complain. GET INVOLVED WITH IRES.

I am humbled and proud to represent IRES as president for the coming year and excited about the many opportunities that confront this organization. Thank you and God Bless.



Stephen E. King, CIE  
IRES President

## “Quote of the Month”

***“I think the SMART Act in its current form would preempt a number of significant responsibilities that the states believe are important to their function as regulators in the marketplace.”***

**— Diane Koken, NAIC President**

## New IRES officers elected

*continued from page 1*

activities have included chairing the Membership and Benefits Committee, and more recently the Accreditation and Ethics Committee. In 1995, he received the IRES President's Award for his work on the mandatory continuing education program.

King has worked in the business of insurance and insurance regulation for over 20 years, spending over 14 years with the Nebraska Insurance Department. While in Nebraska, he worked as an investigator and with the market conduct section as an examiner-in-charge. He left regulation in 1996 and worked as a compliance officer for a life and health company. For the past five years, he has been doing contract examination work for the Colorado Insurance Division. He is a retired Lieutenant Colonel from the Nebraska Army National Guard.

King lives in Salem, Virginia, with his wife, Dolores, and their two children, Molly and Zachary.

After assuming the IRES president's gavel from outgoing president Kirk Yeager, King appointed the Executive Committee members to chair the Society's Standing Committees:

Accreditation & Ethics — Douglas A. Freeman  
Membership & Benefits — Jo A. LeDuc  
Finance & Budget — Karen L. Dyke  
Publications — Kirk R. Yeager  
Meetings & Elections — Katie Johnson  
Education — Polly Chan

In other voting during the Tampa meeting, six regulators were elected to four-year terms on the IRES Board of Directors:

Kirk Yeager, Colorado; Doug Freeman, Missouri; Michael Hessler, Illinois; Betty Bates, D.C.; Polly Chan, California; and Eugene Reed, Delaware.

In addition, the Board appointed IRES members to one-year at-large positions: Vi Pinkerton, Colorado; Delbert Knight, Arizona; and Clarissa Preston, Louisiana.

## Welcome, new members

Andrew Arnott, UT	Arlene M. Barrie, ID
Aaron L. Brandenburg, NAIC	Mary A. Darby, DE
Gerard Edimo, TX	Ted A. Greenhouse, MO
John E. Hardiman, OR	Joseph P. Koch, DE
David R. Moskowitz, TX	Victor A. Mullins, WV
Edwin Pugsley, NH	

# The Commissioners interview (continued from page 1)

**Regulator:** *In this morning's session, Florida Commissioner Kevin McCarty called terrorism an "uninsurable risk." If this is so, is there any real possibility of a long-term solution to the terrorism coverage problem?*

**Commissioner Koken:** I think what Kevin was referring to is that [a terrorism attack] is difficult to quantify and difficult to predict and therefore difficult to price. Insurance is good in any circumstances where [insurers] can model. They can model hurricanes and they can model earthquakes, but they can't model terrorism because it is so unpredictable with regard to where it would hit and what the cost would be. . . . That's one of the reasons why it's critical to have a backstop, but also critical to have a long-range solution to the problem.

**Regulator:** *And not necessarily an insurance industry solution?*

**Koken:** Well, we think it should be a solution where the insurance marketplace certainly participates in coming up with it, but we think it will by necessity include a federal backdrop of some sort.

**Regulator:** *Some people look at the Terrorism Risk Insurance Act (TRIA) as a red state/blue state issue — the urban areas versus the rest of the country. Do any of you see it in that context?*

**Dale:** That's the way Congress sees it. Now the Republicans have pretty much said this is a private enterprise thing and we can't open up the Treasury of the United States to pay for everything. The Democrats probably go to the other extreme . . . . There's got to be some middle ground in my opinion.

**Koken:** This shouldn't be a red state/blue state issue. I think the economy is such today with the reinsurers being global that any [event] impacts on our marketplaces to a much greater extent than it did before . . . . The cost of reinsurance is impacted by one of these events *anywhere*. It's not a red state/blue state issue . . . .

**Dale:** I think we've overreacted in the way the federal government is addressing this. The prime example is Homeland Security. It's the biggest waste of money

at the federal level that's come into my state in a long time. You cannot make me believe that Meridian and Mantachie should be buying gas masks. I just don't see that.

**Regulator:** *Regulatory lines seem to be becoming increasingly blurred. Are you troubled by an Attorney General from one state undertaking such far-reaching investigations into the insurance industry, an area which would seem to be the jurisdiction of state insurance departments?*

**Koken:** With respect to the investigations that occurred, state insurance departments were also very involved in these issues. In the case of New York and California, they were involved at the same time *or prior to* the Spitzer investigations. I certainly think the insurance commissioners have the whole marketplace as part of their responsibility and they understand the balancing and the issues and the potential of unintended consequences from acts. I think state insurance regulators are the best equipped to address insurance-related issues.

**Dale:** Most of us don't like to have our abilities questioned by anybody, but sometimes it benefits us.

**Regulator:** *Along those lines, Commissioner Dale, you made an intriguing point at this morning's session about "voices in the wilderness," such as Herb Denenberg (Editor's Note: consumer advocate and former Pennsylvania Insurance Commissioner Herbert Denenberg), consumer advocate Robert Hunter, and perhaps Eliot Spitzer — individuals who may tweak our collective conscience and make us look at insurance regulation a little differently. Do you have any thoughts on that? Do we need people like this?*

**Bell:** Absolutely. A coordinated effort is always better than a single approach. If you get more than one set of eyeballs on a problem, you're probably going to come up with several different rounds of possibilities or solutions. I have no problem with a coordinated effort.

**Koken:** That's why we have consumer-funded representatives that attend the NAIC meetings because



**Pennsylvania's Koken**

we recognize that you don't get a balanced perspective unless you listen to both sides.

**Bell:** The hurricanes issues task force that I put together in my state had across-the-board representation, from the regulators, from the consumers, from the developers, the builders, the legislators, the city-county representatives. Everybody brings a little different perspective to the table . . . .

**Dale:** Sometimes when these "voices in the wilderness" want to do these things and we know they're done for the right reasons, we're accepting of it. They question us, but we accept it. But when we see their ulterior motive — which may be political — it's a little difficult to swallow. In this case, it's mighty strange that in one week he [Spitzer] was lambasting the industry and a couple of weeks after that he was announcing for governor. Those kinds of things are sometimes a little difficult to swallow.

**Bell** (chuckling): He announced for governor a long time ago.

**Regulator:** *There were concerns that other states would see the success of the New York Attorney General and would pick up on this. Is there any worry that there might be a trend in insurance regulation moving away from the insurance departments?*

**Bell:** I talk to my AG on a regular basis. All of my attorneys basically are deputy attorneys general. So we have that coordinated relationship. He stays completely out of insurance regulation.

**Koken:** In Pennsylvania, our AG is working with a coordinated group of AGs looking at issues. The Attorneys General have a place in this because some of what has been uncovered has been illegal.

**Bell:** Fraud.

**Koken:** It was not something that as state insurance commissioners we have the authority to — at least in my state — prosecute and correct. The bid rigging, the pay to play, anti-trust violations — they are not within the insurance department's responsibility.

**Regulator:** *Even if you had uncovered it, you probably would have called the AG?*

**Koken:** I would have referred it to the AG.

**Dale:** We are an administrative agency in most states. The Attorney General is the statutory agency that deals with criminal matters.

**Koken:** Right.

**Dale:** Sometimes we try to be helpful, but we're not criminal investigators.

**Koken:** And what we're talking about is criminal.

**Dale:** And what a lot of people who are not friends of state regulation will say is "The Attorney General uncovered it. Where was the Insurance Department?"

**Regulator:** *Is it possible to enact something like the State Modernization and Regulatory Transparency [SMART] Act and, at the same time, preserve the state's traditional role as the functional regulator?*

**Dale:** Diane made a point this morning that was very much on target in that there are a lot of differences among our states. Mississippi does things differently than Pennsylvania. To make "one size fits all" [regulation] is going to be very, very difficult, but at the same time we have an industry we regulate that is screaming and hollering

for more uniformity and to get their products to the marketplace. Perhaps we have not responded enough to meet that challenge and we must do it.

**Koken:** I believe we do need to evolve and create better efficiencies because it's the right thing to do. We're moving toward that. I think the SMART Act in its current form would preempt a number of significant responsibilities that the states believe are important to their function as regulators of the marketplace.

**Dale:** I can't see our state legislators and our governors giving up those billions of dollars that we collect in premium taxes that helps run our governments and letting that go to the federal government.

**Koken:** The National Governors Association wrote a very strong letter opposing the SMART Act for exactly

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***If another [Hurricane] Camille hit the Gulf Coast with the development that is there now, there would be poker chips scattered from Biloxi to Pascagoula.***”  
— George Dale, Aug. 1, 2005

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# The Commissioners interview

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the types of concerns that George has mentioned.

**Regulator:** *I believe it's on top of NCOIL's [National Conference of Insurance Legislators] priority list.*

**Koken:** It is; it is.

**Regulator:** *At the same time, what I'm hearing from a lot of states is that legislators — for the most part — are still unaware that their states conceivably can lose millions of dollars in premium taxes should something like the SMART Act be enacted.*

**Bell:** That's because it's not an Act yet, it's a proposal. Every legislator that I talk with once I tell them that we will lose our ability to regulate the property/casualty personal lines market in our state, their antennae go up and they say "No, we're not going to give that up."

**Regulator:** *Do we have any indication when the SMART Act will become an Act rather than a proposal?*

**Koken:** I think there was a desire to mark up the document and possibly get it introduced in July and then there was some indication that it would be later . . . I'm not sure that with TRIA and some of the other issues of importance that this hasn't taken perhaps a little bit of a backseat . . . but I would say not because of a lack of desire on the part of Chairman Oxley or Chairman Baker [Editor's Note: SMART Act co-



**Mississippi's Dale**

authors Congressmen Michael Oxley and Richard Baker].

**Bell:** You know the thing that has occurred while

SMART has been in its proposal stage is that SERFF (System for Electronic Rate and Form Filing) has become a huge player in the insurance market. It's gone from having 3,000 filings in one year to 15,000 filings last year, moving much ahead of that for 2005. The interstate compact has over 33 national standards in place. Eighteen states are now part of the compact, all we need is another eight . . . and we'll have a compact that's operational. The NAIC has made appropriations to SERFF to enhance its ability to do even more in the area of speed-to-market. So many things have been going along at the same time that SMART's been trying to get on track. The NAIC is moving extremely fast to show that state-based regulation is capable of doing the things that people in Washington say they want the SMART Act to do.

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**The NAIC is moving extremely fast to show that state-based regulation is capable of doing the things that people in Washington say they want the SMART Act to do.**”  
— Walter Bell

**Regulator:** *Thank you for joining us this morning Commissioner Bell. I understand you have a plane to catch.*

**Bell:** Yes, thank you.

*(The interview continues with Koken and Dale.)*

**Regulator:** *The House recently passed a bill authorizing Associated Health Plans. What are your concerns, if any, about AHPs?*

**Koken:** Well, we have a lot of concerns about Associated Health Plans. We think the whole issue of the uninsured is a significant problem in all of our states. But we believe that we have the experience and the history with MEWAs and ERISA . . . that says to us that Associated Health Plans are not the best solution to this problem.

**Dale:** I think it's an example of Congress trying to respond to something without being familiar enough with all the facts. I think we've had too many of these federal programs that due to a lack of regulation — particularly on the state level — have not worked out and this is one we're very skeptical of.

**Regulator:** Last year at the IRES CDS in Denver, I sat across from Ernst Csiszar, then president of the NAIC, and less than a week later he had left for the private sector. Commissioner Koken, you were thrust into this position of NAIC President. It must have been difficult for you coming in with the SMART Act and then the Spitzer investigation. What's this year been like for you? What are your proudest moments and some of your regrets?

**Koken:** It's been a great opportunity. I have enjoyed it thoroughly. I've had a chance to meet with people I would not have had an opportunity to meet with. It's the opportunity to put together all the issues and really feel engaged on those issues. The only drawback I would say is that with the marketplace being so significant in size in Pennsylvania, it has really kept me hopping to keep up with my important Pennsylvania priorities as well as to meet the NAIC travel schedule. I would say that the insurance commissioners are a deep bench of very committed, very knowledgeable regulators and although we did lose our leadership, we didn't lose a beat. We immediately were able to address and respond to pressing issues quickly because we have a great team of very committed regulators and you're looking at *the* most experienced member of the group, George. It's been great.

**Regulator:** Is there any topic we haven't touched on or any topic you'd like to address at this time?

**Koken:** I think the only point I would make is one I made this morning that the commissioners are making a great deal of progress in addressing legitimate concerns raised by the marketplace. If you look at our record, we are not always getting the credit we should be getting for all our successes. This is not a group that is saying the status quo is OK. But at the same time we have to be very deliberative about what we do because we regulate a huge marketplace with great economic implications in each of our states.

**Dale:** The weakness I see of our regulatory system is

the continued turnover of insurance commissioners. The number of new ones we've had in the last year is just astronomical. I know I'm extreme on the other end and I know there's an advantage to new ideas, but when someone comes in appointed by the Governor and you have a staff that says, "Well, we don't have to listen to that person because he'll be gone in six months," you create a situation where some person in the back office can give an insurer hell . . . We need to find a way to have commissioners be able to stay a little longer than the 18 months they average now.

**Regulator:** One last question, should there be more of an NAIC presence in Washington D.C. than there is now?

**Koken:** I think that we've always recognized the importance of our presence in Washington. We meet with our counterparts among some of the federal agencies. We meet twice a year with the Securities

& Exchange Commission, the Federal Reserve and a number of other federal agencies. We sit at the table with them to talk about issues. I think that it is important for us to get our message to Congress on a regular basis, but we believe our strength is in the state system.

**Dale:** In the '70s, there was a question as to where to move the headquarters of the NAIC. At the time, the NAIC was headquartered in Milwaukee. The vote [came down to] Dallas, Kansas City or Washington, D.C. Perhaps we would have been better served had we selected Washington, D.C., but we didn't. We selected Kansas City so we make the best of it. Diane's right, it's a drain on us to maintain the presence in D.C. that we probably need to because she's got a job to do; she can't spend all of her time in D.C. So we hire people that represent us there.

**Regulator:** Thank you commissioners. ■



**Regulator Editor Wayne Cotter (head of table) interviews commissioners George Dale (left) and Walter Bell and Diane Koken.**

## Are Service Contracts Insurance?

by Wayne Cotter, Editor

Monday, August 1 (1:30-3:00 PM)

Perhaps it was too broad a topic to cover within the confines of a single CDS session. After all, trying to outline the regulatory ramifications of vehicle service contracts, warranties, home service contracts and home builder warranties is an effort sure to send more than a few heads reeling.

But the audience was engaged and the questions flowed during a spirited Monday session on the distinctions between service contracts and warranties.

**Art Chartrand**, representing the Home Service Contract Association, emphasized that his client's products — home service contracts — differed from other warranties and service contracts in the marketplace. Specifically, he said, regulators should not confuse home service contracts with home builder warranties. They are distinctly different animals.

Calling home service contracts “the inverse of insurance contracts,” Chartrand said they provide service, repair or replacement *for normal wear and tear*, which is never covered under insurance policies. In fact, said Chartrand, the NAIC has agreed with this position since at least 1995.

Not so fast, countered **Doug Stolte**, a Virginia Deputy Insurance Commissioner, who said the NAIC took no such position and claimed to have the documentation to prove it. Although Stolte and Chartrand each began to conspicuously wave their NAIC documents to support their respective views, the issue remained unresolved by session's end.

Stolte said that in Virginia — the only state in which home service contracts are treated as insurance products — consumers typically pays \$350 to \$500 for a contract at the time they purchase their home. The contract promises to provide service, repair or replacement for a one-year period of, say, a water heater or dishwasher should the unit fail.

The problem, said Stolte, is that when claims arise a home service contract provider will often deny coverage, claiming the faulty units were maintained improperly by the former homeowners.

Chartrand said pre-existing condition denials are rare in the industry and home service contracts typically generate few complaints across the U.S.

He stressed again that such products should not be considered insurance, comparing them to other contracts consumers enter into, such as for snow removal services. Under snow removal contracts, a consumer typically pays a fixed fee upfront and snow can be removed any number of times during the season. Such contracts have never been considered insurance, said Chartrand, nor should they be.

**John Chaskey** shifted gears from home service contracts to service contracts in general. In New York, said Chaskey, service contracts are not regulated in the same manner as insurance products. A service contract may take the form of an extended warranty (not issued by the manufacturer) that for additional compensation (perhaps \$50) beyond the selling price provides the buyer with a year of extended coverage.

In New York, service contracts are excluded from the financial requirements imposed on those selling insurance products. Instead, service contract providers can choose among three methods to ensure claims are paid fully and on time.

Unlike warranties issued by manufacturers, service contracts by definition create a “third party obligor,” *i.e.*, the party ultimately responsible for paying claims under extended warranties or similar service contracts. The biggest problem, says Chaskey, is identifying the entity that really is the third-party obligor in a service contract arrangement.

**Ann Frohman**, the Nebraska Department's General Counsel and Deputy Director, narrowed the focus still further, honing in on vehicle service contracts. She stressed the lack of uniformity throughout the country with respect to vehicle service contracts and noted that Nebraska considers vehicle service contracts to be insurance products.

Frohman cited firms, such as the National Warranty Risk Retention Group, that have marketed vehicle service contracts nationally while allowing “turnkey operations,” such as car dealers, to sell the product. She, like Chaskey, emphasized the difficulties in locating third-party obligors to pay claims. In National Warranty's case, the company operated out of Omaha, but was licensed through the Cayman Islands.

The session offered IRES members a feel for the vast array of service contracts offered in today's marketplace and an appreciation for the regulatory nuances that currently exist among the states. ■



## IRES STATE CHAPTER NEWS

**LOUISIANA** — The Louisiana Chapter met May 19. **Trent Beach**, Assistant Director of the Fraud Division, spoke on “Simplifying MEWAs.” On June 16, the Chapter held its Annual Business Meeting, at which time new officers were announced. The newly elected Officers are: **Crystal Campbell**, President; **Linda Gonzales**, Vice-President; **LaQuette Brown**, Secretary; and **Suzanne Aucoin**, Treasurer. On August 11, **Molly Quirk-Kirby**, Director of the Louisiana Property & Casualty Insurance Commission and Legislative Coordinator, reviewed recently passed legislation. Twenty-seven Louisiana staffers attended.

— *Larry Hawkins; lhawkins@ldi.state.la.us*

**NEBRASKA** — Our June meeting featured **Jeanne Daharsh**, FSA, MAAA, Actuary & Administrator for the Life and Health Division, and **Bev Anderson**, CPCU, Administrator for the Property and Casualty Division of the Department of Insurance. Jeanne presented information about the Interstate Compact and the Nebraska Health Care Prompt Payment Act. Bev discussed file-and-use laws for commercial and personal lines, consent-to-rate filings, SERFF, and a Nebraska case regarding actual cash value. Details of upcoming meetings can be found on the IRES Web site.

— *Karen Dyke; kdyke@doi.state.ne.us*

**OREGON** — The Oregon Chapter of IRES held the following meetings:

**April:** **Mark Jungvirt**, Manager, Oregon Insurance Pool Governing Board, presented “Navigating Changes in Oregon Health Care Programs” and **Russell Latham**, Oregon’s Chief Financial Examiner, explained the NAIC accreditation process for financial regulators.

**May:** **Cindy Jones**, Oregon’s Manager, Market Surveillance, presented “Integrating Market Regulation.”

**June:** Oregon’s Rates and Forms staff discussed new prescription benefits and preventative care services. The Market Analysis section of the Oregon Department presented a seminar on prompt pay laws. The prompt pay session was aimed at industry representatives.

— *Gary Stephenson; gary.m.stephenson@state.or.us*

**VIRGINIA** — Thirty-one regulators attended our quarterly Chapter meeting on June 6. **Bob Wright**, Special Projects Coordinator for the Life and Health Division, and **Jackie Cunningham**, Deputy Commissioner for Life and Health Market Regulation, discussed proposed changes to Virginia laws and regulations.

— *Sheryl Hines; Shines@scc.state.va.us*

## TAMPAA



***Congratulations to the AIE Class of 2005 (left) and the CIE Class of 2005. We are proud of you!***

# TAMPA



TAMPA, Fla. — More than 420 regulators and insurance industry experts gathered July 31 - Aug. 2 for the 2005 IRES Career Development Seminar at the Tampa Marriott Waterside.

The seminar attracted regulators from across the country to discuss current issues in complaint handling, producer licensing, life-health and property-casualty regulation, enforcement-compliance, market conduct, fraud, financial solvency surveillance and more.

The two-day program featured 35 different programs, ranging from large general sessions to small, networking breakouts.

The 2006 CDS will be at the Hyatt McCormick Convention Center in Chicago, Aug. 6-8.



**The Kochs of IRES (left to right): Don Koch, market conduct examiner and former IRES president, with children Joe and Nobu Koch and brother Jim Koch. All four are regulators and members of IRES.**



**Don Belanger, a New Hampshire regulator, visits with colleagues during a break.**



**CLOCKWISE FROM TOP — Former IRES President Angela Ford of North Carolina (second from right) is flanked (left to right) by Luther Ellis, Janet LeGore and Lee McLellan, regulators for the District of Columbia**

- An attendee browses the many program offerings
- Fifteen-year IRES member Chuck Pickett of Gainesville, Texas
- Damian Sepanik (left) and the NAIC's Eric Nordman
- IRES Education Committee members hold a final program review Sunday afternoon before the opening of the Tampa CDS.
- (left to right) IRES President Kirk Yeager, CDS Chair Paul Bica and Education Chair Katie Johnson
- Bill McDonald, Laura Archer and Marc Springer of MetLife chat at the IRES registration desk.



## Finite risk has a bad name, but legitimate uses

By *Scott Hooper*

**Tuesday, August 2 (10:30-12:00)**

Finite risk reinsurance, previously an arcane, little-discussed line, has gotten a bad rap in recent months and years — so much so that there will likely never again be a product with that exact name.

Yet this line of reinsurance lives on under different names, names like “structured reinsurance.” And three Tuesday afternoon panelists agreed that might not be such a bad thing.

The problem is that insurers have begun buying policies that, if you look at them carefully, aren’t insurance at all. They smooth financial results, and they can reduce or eliminate credit risk, but in the end they don’t transfer significant underwriting risk. Yet finite policies have been around for some time, and if used properly they can still have some value.

**Vincent Laurenzano**, CFE, an insurance financial consultant with the law firm of Stroock & Stroock & Lavan, said it’s appropriate to use reinsurance to reduce volatility and timing risk.

“All reinsurance is timing — one of the reasons to buy it is surplus relief,” he said during the Financial Section session “Do They or Don’t They?” “Another main reason is to reduce volatility.”

After all, Laurenzano added, “Smoothing earnings is what reinsurance is all about. But in the end,” he said, “there has to be a real risk transfer.”

The use of what were then called retroactive agreements, a.k.a. loss portfolio transfers, began in the late ‘70s, Laurenzano said, with the liability crisis. Though such agreements distorted financial results, creating assets and loss reserves, they were for the most part a legitimate business practice. In 1984, New York regulators required loss portfolio reinsurance to be reported as other income, which produced less distortion to underwriting results.

They still had value, though, said Laurenzano, since there still was transfer of timing and investment risk. The problem, he said, came when the industry added prospective reinsurance, based on the same principle.

“Many of these were pure finance, with little or no risk transfer whatsoever.”

The NAIC responded in ‘94, but its requirement for “significant” risk transfer still left a big loophole. Some have proposed bifurcation, separating risk and financing, but, Laurenzano said, “I have my doubts about it being a good proposal. I doubt it’s good public policy.”

Instead he favors statutory cost change, allowing amortization of acquisition costs over the life of the policy (currently it’s required to be expensed). He also favors allowing loss discounting, which recognizes the time value of money, as well as changing the risk-based-capital formula and adding more disclosures for finite policies.

**Donald F. Thorpe**, managing director at Fitch Ratings, agreed that insurance often serves, quite properly, to smooth financial results.

“The question is whether the policy smoothens the underlying results or just the accounting earnings,” he said. That is, does the accounting accurately reflect what’s going on within the company?

As a rating agency, Fitch has a particular interest in that question. But so do regulators. If finite treaties mask earnings, loss reserves and the like, it may be hard — even impossible — to evaluate a company’s financials, or to compare them to an otherwise similar competitor.

**Joseph Fritsch**, CFE, CIE, Director of Insurance Accounting Policy with the New York Department of Insurance, was the most skeptical of the three panelists.

Despite several tightenings of the regs, there still has to be a “significant level” of risk transfer, which is often translated by industry into the 10/10 rule — there must be a 10% chance that 10% of the premium is at risk. But this is just a rule of thumb and isn’t required by statutory accounting.

Sure, insurance is all about uncertainty, but when two different actuaries or accountants can look at the same transaction and come up with their own separate ways of deciding whether the contract transfers significant risk, something’s amiss. NAIC’s Casualty

*continued on next page*



**Market analysis general session** — AT RIGHT: Sam Binnun of the Florida Insurance Department (left) and Bennett Katz of Farmers Insurance Group field questions posed by moderator Jann Goodpaster (above) about how to improve the uniformity and quality of state regulation. More than 400 regulators and industry members attended the 2005 IRES annual meeting in Tampa.



### *Legitimate uses for finite risk*

Actuarial Task Force is currently reviewing what constitutes significant risk transfer.

In addition, Fritsch said, regulators need access to any side agreements that may hide the true intent of the transaction and the complete underwriting files. The NAIC has adopted a CEO and CFO attestation that requires that the company attest there are no side agreements except as disclosed, and that it have documentation available for review of transfer of risk analysis and for the economic intent of the contract.

Right now, said Fritsch, who chairs the NAIC's P&C Reinsurance Study Group, "a contract that transfers minimal risk and a contract that transfers significant risk receive the same accounting treatment. It's an all-or-nothing approach. Either it transfers risk

and gets full reinsurance accounting treatment or it does not and receives deposit accounting treatment.

"There are some contracts that are a good deal and transfer limited risk at a reduced cost," he added, "but there is some real abuse."

The NAIC has adopted a number of disclosures for contracts that are accounted for as reinsurance, not deposits — documents that, along with the new CEO/CFO attestation, are available at [www.naic.org](http://www.naic.org).

Though additional changes to the regulation are no doubt needed, Thorpe of Fitch said that at best, these agreements will never be easy to understand, if only because they vary so much. "These are not off-the-rack products," he said. "They're highly customized." ■



**President's Award** — Doug Freeman of Missouri (right) receives this year's IRES President's award from outgoing IRES President Kirk Yeager, Colorado. Freeman was honored for his work on numerous IRES committees and special projects, including finance, accreditation, continuing education, membership development and more. The award is given annually to persons who provide extraordinary service to the Insurance Regulatory Examiners Society.

# TAMPA



**AI Greer Award** — Mike Hessler (left) presents the 2005 AI Greer Achievement Award to Dale Emerson, a deputy director with the Illinois Insurance Department. The award is presented annually to an insurance regulator who not only embodies the dedication, knowledge and tenacity of a professional regulator, but who exceeds those standards. It is named after the late Mr. Greer, a former IRES board member and treasurer.



## **LaFong Captures Coveted Schrader-Nelson Award**

Mark Gardner (pictured here with *Regulator* Editor Wayne Cotter and Publications Chair Polly Chan) was this year's Schrader-Nelson "Article of the Year" award winner. Mark's article was written pseudonymously under the *nom de plume*, Karl LaFong. Although Gardner first took the stage to accept his award with a paper bag shielding his face, he eventually revealed his true identity. His article, "Spitzer Probe: What are the Lessons for Regulators?" appeared in the January 2005 issue of *The Regulator*. Our congratulations go out to Mr. LaFong, we mean Mr. Gardner.

# TAMPAA

*CDS: Spotlight on Sessions*

## Get Smart: Debating the SMART Act

*by Janet Glover, CIE, CFE*

**Monday, August 1 (1:30-3:00 PM)**

**Dave Snyder**, President of the American Insurance Association and **Birny Birnbaum**, Executive Director of the Center for Economic Justice engaged in a lively debate on the federally proposed SMART Act at this year's CDS. The debate was not limited to just the two speakers, however. There was a great deal of audience feedback on whether the SMART Act is as "smart" as Mr. Snyder sees it or as "dumb" as Mr. Birnbaum believes it is.

Two general regulatory schemes are being floated in Washington: an optional federal charter for insurers and the SMART Act. In Mr Snyder's opinion the optional federal charter is the preferred choice as it will produce an open competitive marketplace for the benefit of consumers.

However, the SMART Act could serve as a compromise between the optional federal charter and the present regulatory system which he characterizes as inhibiting consumer choice in product and price and insurers' ability to participate in an increasingly competitive global marketplace. According to Mr. Snyder, under the U.S. regulatory system many states have been fixing prices through prior approval or state-mandated rates and have lacked focus on core regulatory issues such as solvency and market conduct.

The SMART Act permits, according to Snyder, the states to play a major role in regulation while not permitting price fixing. It promotes more nationwide uniformity and "frees up regulatory resources to focus on core regulatory issues such as solvency and market conduct."

Mr. Snyder does admit that the SMART Act raises

"many technical and legal issues on exactly how the regulatory system will function."

Mr. Birnbaum presented the opposing view, characterizing the SMART Act as a "fantasy wish list for the industry" that would cripple the states' ability to engage in market analysis and enforcement. He highlighted several sections of the Act that provide for:

- domestic state deference with no resources provided which would in effect "cripple market analysis";
- preemption of state approval, establishment or prior review of rates which would eliminate most state anti-discrimination laws; and
- residual market rates to be self-supporting which could lead to excessive rates.

Mr. Birnbaum also criticized the SMART Act for not providing for oversight of insurers' use of risk classifications which, in his opinion, is an area of significant abuse by insurers.

Mr. Snyder noted that, at the present time, the SMART Act is merely a proposal that had been drafted by Congressional staffers and that comment had been solicited from all interested parties, including the NAIC. Mr. Birnbaum disagreed with Mr. Snyder's assessment of interested party involvement and stated that the NAIC and consumer groups had been excluded in the more recent discussions. An amended proposal is expected sometime in September. ■



*Janet Glover, a longtime IRES member and supporter, served as Deputy Bureau Chief of the Market Division of the New York State Insurance Department's Property Bureau. She retired from state service in August 2005.*



CDS breakout sessions — New York regulator Joe Fritsch (top left) addresses “finite risk” insurance and Ron Poindexter of the National Insurance Crime Bureau (NICB) discusses catastrophes claims and fraud.



# TAMPAA



At the Tampa meeting, the IRES Foundation announced plans to fund an annual scholarship to help send insurance regulators to the annual IRES Career Development Seminar. LEFT TO RIGHT: Jim Fryer and Dave Kenepf of the Foundation board, IRES President Kirk Yeager and Damian Seganik of the Foundation board.

IRES President Kirk Yeager (above) does a live radio broadcast from the Marriott along with talk show hosts Bill Bailey (foreground) and Art Chartrand.



Cheryl Wall and Dave Lorenz of PEMCO Mutual Insurance Company



# Regulatory Roundup

## **CONNECTICUT – Governor signs Bill regulating producer compensation**

Governor Rell signed into law on June 2 Connecticut Public Act No. 05-61, which imposes various conditions on insurance producers who receive compensation from an insurer or other third party for the placement of insurance where the producer receives any direct compensation from the customer. Such producers must obtain from the customer “documented acknowledgment” that the producer will receive compensation from the insurer or other third party. Disclosure to the customer of such a payment must be provided prior to delivery of the policy. The customer disclosure must include the amount of compensation that the producer will receive from the insurer or other third party. In cases where the amount of compensation is not known at the time of disclosure, the producer must disclose the specific method for calculating the compensation and, if possible, provide a reasonable estimate of the amount. The Act prescribes limited exceptions to the customer disclosure requirement. For example, no disclosure is required where the producer does not receive compensation directly from the customer and discloses to the customer prior to the delivery of the policy that the producer will receive compensation from an insurer or other third party. The Act furthermore amends section 38a-816(1) of the Connecticut General Statutes to expand the scope of conduct that constitutes a misrepresentation of an insurance policy as well as an unfair method of competition and unfair and deceptive act or practice in the business of insurance. Under existing law, it is a misrepresentation to make, issue or circulate any estimate, illustration, circular or statement, sales presentation, omission or comparison that is a misrepresentation for the purpose of inducing the lapse, forfeiture, exchange, conversion or surrender of any insurance policy. The Act expressly classifies an intentional misquote of a premium rate to be a misrepresentation. The Act also classifies a misrepresentation to induce the purchase of insurance as an unfair and deceptive insurance

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The New York-based Stroock & Stroock & Lavan LLP Insurance Practice Group includes partners Donald D. Gabay, Martin Minkowitz, William D. Latza and William Rosenblatt. The Insurance Practice Group also includes insurance finance consultants Vincent Laurenzano and Charles Henricks. They gratefully acknowledge the assistance of Todd Zornik, an associate in the group. This column is intended for informational purposes only and does not constitute legal advice.

by  
**Stroock & Stroock &  
Lavan LLP**

practice. The Act becomes effective on October 1, 2005. *To view the Act, visit [www.cga.ct.gov](http://www.cga.ct.gov).*

## **FLORIDA – Governor signs legislation governing property/casualty insurance**

Due to the perception that many Florida residents who filed property loss claims following hurricane activity in 2004 were inadequately insured because of the difficulty in understanding the nature of property insurance policies, Florida Senate Bill 1486 was signed into law by Governor Jeb Bush on June 1. Among other provisions, the Bill directs the formation of an advisory committee to develop policy language reflecting general industry standards for comprehensive coverage under personal lines residential insurance policies as well as a checklist that would accompany each such policy. Insurers would not be required to offer the policy unless required to do so pursuant to a further act by the Legislature. Senate Bill 1486 also authorizes the Florida Commissioner of Insurance Regulation to restrict insurers’ cancellation or nonrenewal of a personal residential or commercial residential property insurance policy covering a dwelling or residential property located in Florida that has been damaged due to hurricane or wind loss that is the subject of the declaration of an emergency. In addition, Senate Bill 1486 requires insurers to deliver a comprehensive checklist of coverage and an outline of coverage on or prior to the initial issuance and subsequent renewal of a basic homeowners, mobile homeowners, dwelling or condominium unit owners policy. Senate Bill 1486 further amends existing provisions applicable to hurricane deductible options. *To view Senate Bill 1486, visit [www.flsenate.gov](http://www.flsenate.gov).*

## **MICHIGAN – Circuit Court invalidates rules banning use of insurance scores in the rating of insurance policies**

In *Insurance Institute of Michigan v. Commissioner of the Office of Financial and Insurance Services* (File No. 05-156-CZ), an unpublished decision dated April 25, 2005, the Michigan Circuit Court for the County of Barry invalidated and enjoined the enforcement of rules issued by the Michigan Commissioner of the Office of Financial and Insurance Services (OFIS) prohibiting the use of insurance

*continued on next page*

## **Regulatory Roundup**

*continued from previous page*

scores in the rating of insurance policies or as a basis for limiting or refusing coverage. The opinion noted that the role of the state in setting insurance rates is limited. Rates are determined by each insurance company, although they must not be excessive, inadequate, or unfairly discriminatory. A rate is not excessive unless it is unreasonably high for the coverage and the Insurance Commissioner determines that a reasonable degree of competition does not exist for that type of insurance. A rate is unfairly discriminatory if differences in rates are not justified by differences in losses or expenses. The court stated that the effect of the OFIS rules is to increase the premiums of policyholders who represent lower insurance risks and to decrease the premiums of policyholders who represent greater insurance risks. The court explained that the Insurance Commissioner has no authority to order a reduction of rates without a finding that they are excessive. Such a finding is not possible in this instance because OFIS has acknowledged that a reasonable degree of competition is not absent with regard to the classification, kind or type of risks at issue. Also, the Insurance Commissioner did not hold any hearings on a company-by-company basis to determine whether each insurer's rates were excessive. The court also found the OFIS rules to be illegal because of the strong correlation between insurance scores and the risks associated with a given policyholder. Accordingly, the court invalidated the rules and enjoined their enforcement.

### **SOUTH CAROLINA – Department of Insurance issues bulletins on catastrophic modeling for property and casualty insurance coverages**

The South Carolina Department of Insurance issued Bulletins 1-2005 and 2-2005 on May 26 and June 22, respectively, providing guidance on the use of catastrophic models in property/casualty insurance ratemaking. Bulletin 1-2005 strongly encourages insurers to file models with the Department prior to submitting any rate filing that is based upon such model. That way, insurers making a rate filing may reference the corresponding accepted model and version. Both insurers and model developers are permitted to submit model-only filings for review by the Department. Bulletin 1-2005 sets forth a list of items that must be included in any model-only filing. For example, the filing must describe how the model defines "hurricane," provide a detailed description of the historical storms used in developing the probable storms used to run the model and provide details on the process used to develop the expected paths for storms that impact South Carolina. Bulletin 1-2005 states that hurricane models are considered to be trade secrets and proprietary information, and therefore, are not

subject to disclosure under the South Carolina Freedom of Information Act. However, proprietary and confidential information in the filing must be conspicuously stamped as such on each page. Bulletin 2-2005 was issued to clarify the Department's position regarding homeowners rate filings that rely on catastrophe models prior to the approval of such models. Insurers may submit homeowners rate filings prior to the approval of the underlying catastrophe model and the Department will not reject the rate filing pending approval of such model. If the model is later disapproved, the Department will notify the parties that the model may no longer be used by the insurer or that the insurer must amend its rate filing to incorporate changes to the model. *To view Bulletins 1-2005 and 2-2005, visit [www.doi.state.sc.us/Eng/Public/Bulletins/Bulletins.asp](http://www.doi.state.sc.us/Eng/Public/Bulletins/Bulletins.asp).*

### **VERMONT – Legislature considers insurance anti-fraud legislation**

The Commerce Committee of the Vermont House of Representatives recently voted to approve House Bill 150, which would establish the offense of insurance fraud, prescribe corresponding penalties and require insurers to file anti-fraud plans with the Vermont Banking, Insurance, Securities and Health Care Administration (the "Administration"). Examples of acts that would constitute fraudulent insurance acts under House Bill 150 include, without limitation: (i) the presentation by or on behalf of an insured, claimant or insurance applicant to an insurer of any information containing false representations as to, or any omission of, any material fact concerning an insurance application, claim or payment; (ii) the presentation to an insurer, insurance professional or insurance premium finance company of any information containing false representations as to, or any omission of, any material fact concerning the solicitation for sale of any insurance policy, an application for certificate of authority, the financial condition of any insurer, or the acquisition, formation, merger, affiliation or dissolution of any insurer; and (iii) solicitation or acceptance of new or renewal insurance risks by or for an insolvent insurer. Penalties for committing a fraudulent insurance act would be up to \$10,000 and/or imprisonment for up to five years for a first offense and, for a second or subsequent offense, up to a \$20,000 penalty and/or imprisonment of up to five years. A person damaged by a fraudulent insurance act would have standing to sue the violator for damages and other relief in a civil action (other than a class action) subject to various conditions and limitations. House Bill 150 would also require insurers to file an insurance anti-fraud plan with the Vermont Insurance Commissioner. The Vermont House of Representatives did not pass House Bill 150 prior to adjournment. According to news reports, however, the House will resume consideration of the Bill next year. *To view House Bill 150, visit [www.leg.state.vt.us](http://www.leg.state.vt.us).*

# Casual Observations

## The Cruellest Month?

### Not in Tampa

T.S. Eliot dubbed April the cruellest month, but August gets our vote. We've never been able to maintain a cheery temperament under August's blistering sun. In fact, given our druthers we, like President Bush, would take the entire month off (but certainly spend it far, far away from Texas).

That's why we're always astounded to see folks not only keeping their cool, but flourishing during the dog days of summer. Take Tampa, for example. During this year's CDS, most everyone at our hotel from concierge to bartenders to car jockies seemed to be genuinely enjoying themselves. Yes, we know they get paid to be perpetually pleasant, but their attitude went well beyond servile allegiance to an employer.

And when we rode Tampa's new electric trolleys into Ybor City, Tampa's Latin Quarter, a congenial conductor shared with us the story of **Vincente Martinez Ybor** who helped transform Ybor City into the "Cigar Capital of the World" in the early 20th Century, surpassing Havana as the world leader in the production of hand-rolled, quality stogies.

That's not all. We learned Tampa's new trolleys were built on the original undercarriages from the turn of the century and that each refurbished car cost Tampa about \$750,000. We also found out why Ybor City's cigar industry collapsed like a \$3 suitcase in the 1930s and exactly who

was responsible for the demise of trolley cars in the U.S. All this within the space of a 15-minute trip!

We've been riding New York subways for more than three decades and have never learned anything from a conductor other than to "use all doors when exiting" (an instruction we've always viewed as physically impossible to execute).

Tampa residents also hailed one of their own that week-end, **Wade Boggs**, who took his place among baseball immortals in the Hall of Fame. His face and words dominated the St. Petersburg/Tampa media during our brief stay.

And that Tampa spirit certainly shone through in Mr. Boggs' acceptance speech that Sunday. Having languished for six years in the minor leagues, Boggs spoke eloquently of the power of positive thinking in the face of adversity. He said:

Our lives are not determined by what happens to us, but how we react to what happens, not by what life brings us, but the attitude we bring to life. A positive attitude causes a chain reaction of positive thoughts, events and outcomes. It is a catalyst and it sparks extraordinary results.

Tampa residents seem to have taken Bogg's message to heart and perhaps beleaguered insurance regulators — in these trying times — would be well advised to do the same.

— W.C.

# C.E. News

IRES would like to welcome Doug Freeman, CIE, Missouri, as the new 2005-2006 chair of the Accreditation Committee.

Compliance Year 9/1/04 – 9/1/05 has come and gone, but IRES gives you 30 days to submit your CE hours. Your compliance form and documentation must be received at the IRES office by Oct. 1, 2005. KEEP IN MIND the hours you turn in must fall between 9/1/04 and 9/1/05. If you find yourself short 1-3 CE hours, you can turn in a Reachback form that allows you to go back one year and use up to three unused CE hours. The Reachback form was

sent to everyone in May but you can also download it from the IRES Web site.

Those who did not request an extension by September 1 or do not submit a compliance form by October 1 run the risk of having their designation lapsed.

If your designation was received after June 1, 2005, no CE hours will be required until the new compliance period beginning September 1, 2005.

Members having an AIE or CIE who picked up their certificate at the Career Development Seminar in Tampa were automatically given 15 CE hours and do not need to turn in a compliance form.

## The Regulator®



Published by the  
Insurance Regulatory Examiners Society  
12710 S. Pflumm Rd., Suite 200, Olathe, Kansas 66062

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## TAMPAA

**IN THIS ISSUE: Stories and pictures from the  
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