The Regulator®

INSURANCE REGULATORY EXAMINERS SOCIETY

Mud, debris, lawsuits, consumer complaints — life after Katrina

by Scott Hoober
Special to The Regulator

Some call it the nightmare scenario: The worst possible thing that could ever happen. Insurance actuaries call it the PML. Probable maximum loss.

In 1992, Hurricane Andrew exceeded everyone's PML, proving that even actuaries can make mistakes. The entire industry, companies and regulators alike, responded to the reality that storms could be bigger than they'd ever imagined, and they began drawing up dire scenarios and planning for the worst.

PHOTO: Loretta Worters, Insurance Information Institute

One of the worst would of course be a category 4 or 5 storm coming across the Gulf of Mexico and slamming into New Orleans, a major U.S. city that lies below sea level and was surrounded by levees that, at best, were designed to withstand a category 3 or 4. And the rest of the Gulf Coast was nearly as vulnerable, with low-lying communities on the beaches in Texas, Mississippi, Alabama and Florida waiting to be hit by another Andrew.

Or another Hurricane Betsy, which slammed into the Florida Keys and the Louisiana coast in 1965, leaving 75 dead. Or worse yet, another Hurricane Camille, which pounded coastal Alabama, Mississippi and Louisiana in 1969, when the shoreline was mainly lined with single-family homes, hotels, motels and small retail shops — and killed 256.

As Mississippi's commissioner, George Dale, said in an interview in Tampa during the 2005 CDS (published in the

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California targets illegal title arrangements

by Rebecca M. Westmore

EDITOR'S NOTE: *This article, by Rebecca Westmore of the California Insurance Department, focuses on California's recent investigation of the title insurance industry. In the next issue of* The Regulator, *consumer advocate Birny Birnbaum will review recent regulatory initiatives in the title industry from a national perspective.*

It is illegal in California for a title insurer, underwritten title company or controlled escrow company to pay an inducement to any person for the placement or referral of title business.* The penalty for doing so includes the restriction or suspension of a Certificate of Authority, and the assessment of a monetary penalty equal to five times the amount of the inducement.

California Insurance Code Section 12404(c) itemizes various activities that are deemed inducements for the placement or referral of title

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From the President

Be a part of it.
Chicago this summer.

I begin this month's article hoping that this past holiday season has been a joyous one for all. It is also my hope that each of us was able to demonstrate the true spirit of the season by giving to others. It is that unselfish act that makes it clear, it is better to give than to receive.

It is now official. You can mark the dates on your calendar (August 6-8), as it is time to begin making plans for attending the 2006 CDS in Chicago, at the Hyatt Regency McCormick Place. We have completed the planning phase of the CDS and it is clear that the CDS co-chairs — Mike Hessler and Steve Martuscello — and all Section Chairs are excited about the program for the 2006 CDS. This event promises some new twists in terms of format changes and lively discussion sessions of current issues.

Now, aside from the many educational opportunities available at the CDS, were you aware that Chicago is home to one of the world's most famous shopping districts? So why, you're asking, isn't our CDS held on Michigan Avenue? The answer is simple, yet logical: to make it more affordable for our members to join us in Chicago.

Generally speaking, hotel rates along Michigan Avenue range from $200 and up. Those hotels that are less expensive (small, independent hotels), do not have the space to accommodate a meeting of our size. The Hyatt Regency McCormick Place proved to be the perfect solution. It offered a low daily rate ($150 flat rate for single and double occupancy) and is located literally minutes from the "Magnificent Mile."

There, now you have the CDS basics and you can bet we will be providing you more information in the coming months. Remember, mark your calendars. (Oh, by the way, don't forget about the Cubs and the World Champion White Sox. More to follow.)

I'll be seeing you in Chicago.

Take care and may God bless.

Stephen E. King, CIE
IRES President

IRES STATE CHAPTER NEWS

COLORADO — In October, Deputy Commissioner **Erin Toll** gave a presentation regarding affiliated business arrangements in the title industry. The following month **Mike Barber** of CCC Information Systems and **Arthur Chartrand** discussed automobile valuations and in December, **Robert Pierce**, Program Administrator for the Senior Health Insurance Program, provided training on Medicare Part D.
— Dayle Axman; *Dayle.Axman@dora.state.co.us*

DELAWARE — The Delaware chapter is partnering with the National Association of Insurance Women/ International (NAIW) and other professional insurance associations to develop continuing education programs for Delaware regulators.
— Cynthia Lamma; *Cynthia.Lamma@state.de.us*

WASHINGTON, D.C — The International Association of Privacy Professionals (IAPP) recently honored **Bill McCune** of the D.C. Chapter. McCune is Supervisory Examiner Manager of the D.C. Department of Insurance, Securities and Banking. The Association recognized Bill as among the first of its international membership to pass its rigorous national exam. Bill now qualifies for the Certified Information Privacy Professional (CIPP) designation. In September, members shared information regarding the most recent CDS workshops attended and discussed membership and recruitment incentives. We have one additional member coming on board soon, and one prospective member.
— Betty M. Bates; *betty.bates@dc.gov*

NEBRASKA — Our October meeting speakers were **Bev Creager**, Administrator of the Licensing Division and **Reva Vandevoorde**, Supervisor of the Market Conduct Division, both with the Nebraska Department of Insurance. Bev addressed two NAIC model laws relating to producer licensing: the Authorization for Criminal History Record Check Model Act and the Fiduciary Responsibility of Insurance Producers Model Act. Reva explained how the changes will affect market conduct regulation if approved by the NAIC and enacted in Nebraska.
— Karen Dyke; *kdyke@doi.state.ne.us*

Katrina and insurance: The worst that could happen

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September '05 *Regulator)*, "If another Camille hit the Gulf Coast with the development that is there now, there would be poker chips scattered from Biloxi to Pascagoula. . . . Will [the casinos] withstand a storm? We don't know."

Dale's oracular powers were proven only a few weeks later when Hurricane Katrina came ashore, scattering not only poker chips but the casinos themselves — one of which was picked up and tossed on top of a Holiday Inn.

He and his counterpart in Louisiana, J. Robert Wooley, have been in the thick of storm recovery ever since, so we thought we'd try to catch up with them and see how things were going.

Slow recovery

Months after the storm blew through, the levees broke and the beaches washed away, it often appears — at least from the images on the evening news — that little had changed.

But both Dale and Wooley say that the pace of recovery, though understandably slower than following lesser catastrophes, is moving along pretty well. At the three-month mark, Dale estimated that 90% of the claims in his state had at least been adjusted. In Louisiana, where devastation in low-lying New Orleans was especially concentrated, the figure was 75%, said Wooley.

But the workload, particularly on Department members answering calls from consumers, as much as it's dropped, hasn't gotten back to normal.

"The workload on the Consumer Services Division has not slowed down," said Dale.

What has happened is that most of the routine questions have been asked, he said, meaning that the calls now are coming from the more contentious people, and the tougher issues.

In Louisiana, said Wooley, "It's getting better. We're finally down to working six days a week, 12 hours a day.

"A couple of weekends ago, we finally weren't getting enough volume of phone calls on Sundays, so we decided to give our people some rest on Sunday."

Though the two states responded in similar ways — forced to stay out of the worst-hit areas for the first week or two, then going in as soon as it was safe — the differences mattered too.

Mississippi, overwhelmed with consumer calls, got help from an unexpected source: the National Association of Insurance Commissioners. NAIC dedicated four people and four phone lines to handle overflow from Dale's staff.

Across the state line to the west, Wooley's larger department was better able to handle the increased workload, with the help of additional people brought in for the occasion.

"The day after the storm," Wooley said, "we put together a budget of what we would need in extra equipment — we bought some more phone lines, we put in some more phones and computers — and we got authority to hire an additional 75 people," though they've needed to hire only 40 of them.

It wasn't too difficult to make that financial commitment since the Louisiana Department is entirely funded by the revenue it generates. (Day-to-day operations are pretty much covered by fees, fines and penalties, with the $180 million in annual premium taxes going directly to the state's general fund.) Large or small, wealthy or not, though, recovery from a mega-catastrophe of the likes of Katrina, not to mention its sister storm, Rita, has been slow but steady.

As Mississippi's Dale put it: "We have been very successful in just grinding it out, day after day. . . . It's a slow process."

Mississippi

Much of the press attention following the storm has been focused on New Orleans' Lower 9th Ward, where residents haven't even begun to return, and may never return. But the same situation exists to the east, where Mississippi coastal towns like Bay St. Louis and Waveland have virtually disappeared.

"A large number of people are still gone from the coast," said Dale.

The longest-tenured commissioner, with 30 years in office, Dale said "I've never seen anything like this."

He's also been around long enough to recall when the Mississippi coast was a very different place. As late as the 1960s, it was known as the Redneck Riviera, a place where you could go and party (and drink too, with bootleg liquor sold openly in some locales despite Mississippi's formal status as a dry state).

Camille, charging ashore in '69 with 200 m.p.h. winds, changed all that, sending the coast into a long decline, a decline that ended only in 1992 with approval of casino gambling. The state's 32 casinos until recently paid $315 million in taxes, two-thirds to the state, the other third to the local communities.

> *It's getting better. We're finally down to working six days a week, 12 hours a day.*
>
> **— Louisiana Commissioner Wooley**

With that kind of number in the air, the casinos are likely to return (they've already been granted permission to build on dry land, as long as they're 800 feet or more in from the coast). And with them will come hotels, condos — and jobs.

Yet Dale wonders whether the place will ever be the same.

Perhaps, he says, there will be more condos and more snowbirds (as Southerners call Northerners who fly south for the winter). With whole towns wiped off the map and historic homes and commercial buildings no more, the place will certainly look different.

For now, we're left to speculate, since in many areas little real construction is going on.

"A lot of things are going on behind the scenes," said Dale, "but the actual construction is not going on."

Homes that lost roofs have been fixed, he said, but beyond little things like that, major reconstruction is awaiting not only individual decisions and insurance payouts, but also governmental decisions, such as zoning, and perhaps new building codes as well. The issue is a controversial one, despite data showing clearly that improving building codes will indeed reduce damage from the next Big One.

In a way, it makes sense, though.

After all, hurricanes hit that area all the time. Yet it's been 36 years since Camille, 36 years without a storm surge of 30-plus feet. A lot of coastal residents are probably saying, if I can make it another 30-some years with the old codes, why change?

Then there's the issue of wind vs. water damage.

Mississippi has been the eye of that storm, with its attorney general filing suit to increase the burden on insurers.

"His lawsuit attempts to void the contract that had been in effect for years," said Dale.

The commissioner got tarred with the in-bed-with-the-industry brush in the early days of the catastrophe, when he predicted in public that some damage wouldn't be covered by insurance. "All I did was step forward and tell the truth."

At the same time, though, Dale feels that the A.G.'s lawsuit, along with efforts by Richard Scruggs, a renowned plaintiffs' attorney who hales from Mississippi, may do some good. Not that they have a leg to stand on — wind vs. water has been adjudicated too many times in the past for that — but perhaps the adverse publicity will persuade companies to be as generous as possible with their customers.

The issue has clearly been a loser for the industry, no matter how legally right they are.

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The Katrina nightmare continues for regulators

continued from previous page

"If it were not for the question of wind and water damage," Dale said, "I think the insurance industry would have gotten good marks" for its response to Katrina.

Louisiana

Wooley agrees that the standard HO policy is clear about what's covered and what isn't. And he too feels the companies have been doing the best they can.

Photo: Loretta Worters, Insurance Information Institute

"I think companies are paying up the claims that they're legally obligated to pay," he said. "How can you make somebody pay for something that they never received premium for, and that they never reserved for?

"I don't know how you can do that," he added. "At some point, somebody will go broke, and then people with legitimate wind claims will be left with nothing.

"I think that some of the larger companies have been more liberal, because everybody knows that the wind blows hard before the water rises. Everybody knows that. And I think the bigger companies, the ones that can afford to, have liberalized some of their coverages — where there's a doubt, like where there's a slab and it's impossible to tell," they're giving the benefit of the doubt.

One of the burdens of all public officials following a catastrophe of this magnitude is the intense press coverage.

Everyone who's ever been in the public eye knows that the empty barrel makes the most noise. Along the Gulf Coast, as in Florida after Hurricane Andrew, despite what you hear or see or read, the overwhelming majority of consumers are being treated fairly.

"For every one horror story you hear," Wooley said, "there are ten great stories out there, where the company did the right thing.

"That's what I've been finding here in Louisiana. This happened on national TV, and these are national companies. They can't afford to get the reputation of screwing over their policyholders."

But one big question remains: Does New Orleans have a future?

Wooley is convinced it does. Before Galveston, Texas, got destroyed by a huge hurricane a century ago, it was the leading city in the state, and one of the biggest and fastest growing in the region. After the storm, though the city came back, the little backwater of Houston took its place as the leading metropolis, the town with a future.

What's to keep New Orleans from fading away like Galveston? Wooley is convinced that more than anything else, it's the city's role as a port.

"The port is why we made the Louisiana Purchase," he said.

"All the other land that we got was lagniappe, I mean, the whole reasoning behind the United States purchasing the Louisiana Purchase was to gain control over the Port of Orleans.

"Two-thirds of this country drains past New Orleans. When it rains in New York, a week later it's rolling past New Orleans."

Indeed, one of the first economic effects of Katrina was on Midwestern farmers, who could no longer get their crops to market. Months later, commodity prices remain low because of the scarcity of barge traffic to and from New Orleans.

Throw in the city's reputation as a place to visit — think Mardi Gras, the Superdome and

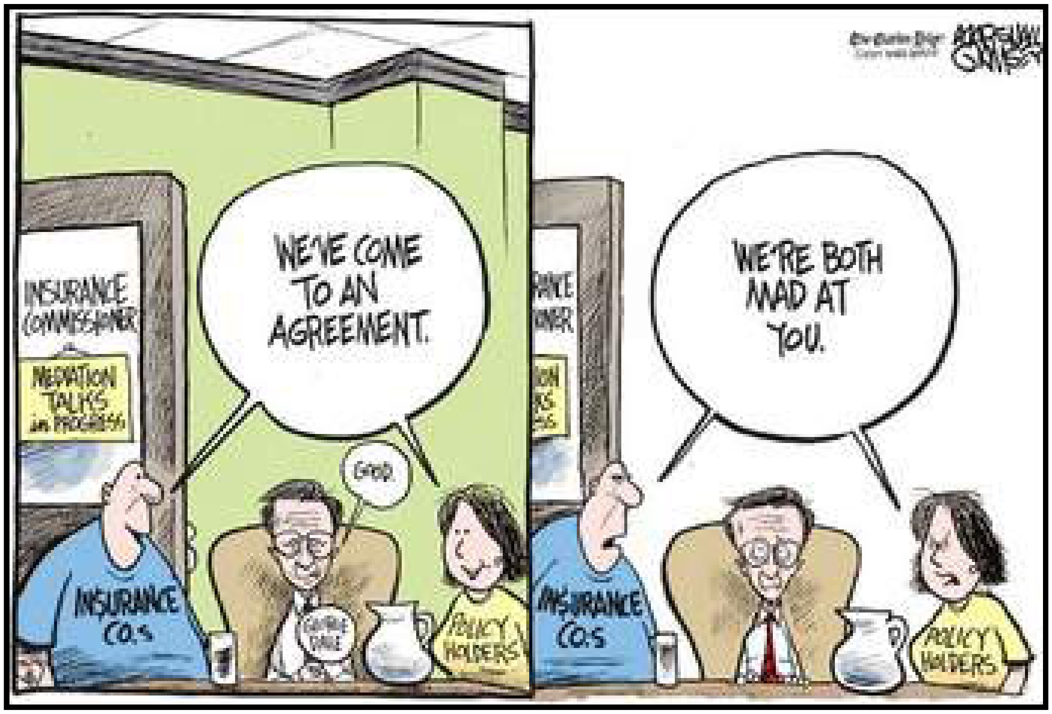
Convention Center, the hotels and restaurants — and the city almost has to return. If not for them then for the rest of us. But maybe not right away, and maybe not in quite the same form.

"It's going to be a while," Wooley said.

"It's not going to be as quick as people around here want it to be," he added. "That's what you've got to constantly remind yourself, and everybody else, so they stay focused in the right direction. The focus shouldn't be 'How quickly can we get back up?' It should be 'Let's get back up, but let's do it the right way.'

"Realistically, it's going to be ten years before it's all the way back. And it's going to be a different group of people. It's not going to be the same people.

"But right now," Wooley added, "there's somebody shoveling their sidewalk in Minnesota today who's tired of shoveling snow, who's going to say 'You know what? I'm going to take my entrepreneurial spirit, and my money, and I'm going to New Orleans.' I think you'll see a lot of that."



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The lessons of Katrina

Some clouds are awfully dark. After the likes of Katrina, the only silver lining may be the thought that we can learn from the experience so we're better prepared next time around.

Is the big lesson that we need to do a better job on consumer education? Perhaps if regulators had tried just a little bit harder, home and business owners would have known to buy flood coverage, would have been less surprised at what's in (and not in) the policy language.

As Wooley said, "I'm on TV every year going: 'Homeowners does not cover flood. It's hurricane season. The biggest danger is from flooding. If you don't buy it any other time of year, buy it for hurricane season, for that six-month period.'

"What's going to happen is that a lot of people are going to buy it — I guarantee it — for next year, and then when they don't have to use it, they'll drop it — and never buy it again."

OK, so maybe except for better levees and more attention to wetlands, prevention isn't the answer. How about the response?

Both Dale and Wooley say that mediation is a new and essential tool for resolving disputes following a major catastrophe. It's got a good track record, from Oklahoma following the '98 tornadoes to Florida in every recent hurricane season. Indeed, Louisiana's new mediation program is patterned after Florida's.

How about global warming? Should we be concerned that Katrina and the Florida hurricanes of the past two seasons are the start of a new and scarier era of megastorms? Maybe so.

Wooley says he was shocked by a graphic he saw at the recent NAIC quarterly meeting. Prepared by the Insurance Information Institute, it showed that the top five all-time catastrophes to hit the U.S. all have struck in the past 13 months.

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Katrina and insurance: the nightmare continues

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For all the gloom, there is one thing that both Dale and Wooley agree needs to be a big part of the nation's reaction to Katrina — a TRIA for natural disasters as well as for terrorist attacks.

Just like terrorism, the impact of catastrophes is widespread and impossible to predict. And if it affects the whole nation, shouldn't the nation pay for it?

"I think what we're going to do is look at a national catastrophic type of facility, for lack of a better word," said Wooley.

"Montana doesn't want to pay for hurricane damage in Louisiana, so what you have to do is tie it to what you would consider a mega-catastrophe, no matter what the source is, whether it be terrorism, whether it be a hurricane, whether it be a mudslide, a wildfire, an earthquake."

What would the cutoff be? A figure of $20 billion has been bandied about, something large enough to be beyond the reach of traditional insurance, large enough to be considered a national disaster.

As Dale put it, "I don't believe the insurance industry is big enough to handle things like this."

Realistically, though, coastal storms will remain the biggie. After all, something like half the nation's population lives within 50 miles of a coastline. But if combining hurricanes with other catastrophes makes it more palatable to the public at large, so be it, for clearly local and state governments shouldn't have to go it alone any more than insurers should.

Right now, the government does respond, but only piecemeal, as it used to after major floods.

That's why the National Flood Insurance Program was born. Floods can hit anywhere, so why not a national program? Plus, as NFIP has evolved in recent years, the program has become a vehicle for big-time mitigation, with flood-prone towns moved uphill en masse in a couple of cases.

With or without global warming, we're clearly in for more major storms over the next few years. Let's hope a federal backstop and an upgraded FEMA are in place by the time the next one hits.

In the meantime, consider calling your counterpart in one of the coastal states (or coming to this year's CDS and engaging in some of those hallway chats), the better to start getting your department ready for your own Big One. ■

In Memoriam: Lewis Shayne

IRES members as well as New York Insurance Department staff members were saddened to learn that on November 21 Lewis Shayne, CIE, a Principal Examiner with the New York Department, was murdered on his way home from his downtown Manhattan office. Lewis, who began his career at the New York Department in 1975, was an active participant in many IRES committees, most notably the Accreditation and Ethics Committee (A&E).

Lewis took particular interest in updating the National IRES Continuing Education (NICE) Program Manual, which governs the IRES continuing education program. He converted the entire NICE manual to a Word Document that will make it easier for IRES members to print out pertinent forms from the IRES Web site. While this project is still ongoing, it is in its final stages, thanks to Lewis' dedication and persistence.

The A&E Committee looks forward to completing this project as a living memory to Lewis' commitment to IRES.

Lewis was 57 years old. His murder occurred outside his apartment building in Forest Hills, New York. He is survived by his mother who suffers from Alzheimer's disease.

Title insurance from a California perspective

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business. Those activities include paying business expenses and cash, providing merchandise, placing compensating balances, advancing escrow funds, and furnishing employees for services unrelated to the title business to any person who has an interest in real property or to any agent, representative, attorney, or employee of the person who has an interest in real property.

The California Department of Insurance has investigated numerous inquiries and complaints, from both consumers and competitors, of illegal rebate activities by title insurers and underwritten title companies. Since 2001, the Department has prosecuted 26 title companies for unlawful rebate activities ranging from spa treatments to cash payments.

The rebates were directed to lenders, homebuilders and real estate brokers who referred title business to these companies. The penalties assessed have included Orders to Cease and Desist, license restrictions, suspension of marketing efforts, cost reimbursements, restitution payments up to $15 million, and monetary fines ranging from $590,000 to $5.4 million.

Stand-Alone Captives

The most recent outbreak of illegal rebate activities in California involved captive title reinsurance arrangements between title insurers and mortgage lenders, homebuilders, and real estate brokers. The arrangements between title insurer and mortgage lender or homebuilder involved the creation of a reinsurance company under Vermont law, and more commonly referred to as a Stand-Alone Captive.

The Stand-Alone Captives were owned, operated, controlled and/or affiliated with the mortgage lender or homebuilder, and according to the terms of the Automatic Reinsurance Agreement, called for the title company to reinsure all the title business it received from the mortgage lender or homebuilder. In consideration for this agreement, the title company agreed to deduct a transaction processing fee of up to $250 for performing the examination and search, and cede the balance of the policy premium on a 50% quota share basis to the mortgage lender or homebuilder for assuming 50% of the risk.

In the case of the real estate broker, however, the title insurer itself established, owned, operated, and controlled a reinsurance company formed under Vermont law, and more commonly referred to as a Sponsored Captive. Under the terms of the Participation and Reinsurance Agreements, each real estate broker was assigned a Cell Number under which it would participate in the captive reinsurance arrangement. In consideration for reinsuring all the title business it received from the real estate broker, the title company agreed to deduct a transaction processing fee of up to $300 for performing the examination and search, retain 80% of the balance of the policy premium, and cede 20% of the balance of the policy premium to the real estate broker for assuming 20% of the risk.

Investigation Launched

In November 2004, in response to an inquiry by the NAIC, the California Department of Insurance launched an examination of the title industry to determine how many title companies were engaged in captive reinsurance arrangements with mortgage lenders, homebuilders, and/or real estate brokers.

The Department reviewed and analyzed documents relating to the negotiation of captive reinsurance arrangements, Stand-Alone Captive Reinsurance Agreements, and Sponsored Captive Participation Agreements provided by the title companies. All of the agreements involved the reinsurance of single-family residential properties.

The Department also reviewed and analyzed the Annual Statements filed by the respective title companies. All of the annual statements reported total ceded premiums provided to captive and sponsored reinsurers.

Schedule F of the Annual Statements indicated recoveries of zero dollars from the captive reinsurers on losses, anticipated recoveries of zero dollars from the captive reinsurers on claims, and anticipated recoveries of zero dollars from the captive reinsurers on claims that had been incurred but not yet reported. Schedule F also revealed that none of the title companies reported reinsurance losses ceded through the captive

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Title insurance from a California perspective

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reinsurance agreements.

In April 2005, the Department conducted an Investigatory Hearing to hear testimony from title industry executives regarding these captive reinsurance practices. According to the title insurers, the captive reinsurance arrangements were necessary to spread the risk of loss and to keep up with competition in the marketplace. The evidence revealed, however, that the reinsurance entities were shell corporations that had no offices and no employees; that there was no legitimate title risk to reinsure because losses from title insurance claims were well under 10% of premium; and that the captive reinsurance arrangements were established for the purpose of ceding premium to entities that had a direct interest in real property. The payment of inducements to procure title business from mortgage lenders, homebuilders, and real estate brokers is a violation of State and federal law.

In July 2005, the California Department of Insurance served Accusations on 12 of the largest title companies transacting title business in California, along with their Stand-Alone and Sponsored Captive Reinsurers. These included Chicago Title Insurance Company, Fidelity National Title Company, Fidelity National Title Company of New York, Security Union Title Company, Ticor Title Company, FNF Reinsurance Company, First American Title Insurance Company, First American Reinsurance Company, Commonwealth Land Title Insurance Company, Lawyers Title Insurance Corporation, Transnation Title Insurance Company, and LandAmerica Reinsurance Services, Inc.

Settlements Finalized

In November 2005, the California Department of Insurance finalized the settlement of the Accusations against 8 of the 12 title companies. Chicago Title Insurance Company, Fidelity National Title Company, Fidelity National Title Company of New York, Security Union Title Company, Ticor Title Company, and FNF Reinsurance Company agreed to cease and desist from engaging in captive reinsurance arrangements with unlicensed entities and from engaging in illegal rebate activities; to cooperate with the Department to identify and file for appropriate rate reductions and improve consumer awareness of title insurance rates; to work with the Department to prevent illegal rebate activities; to pay restitution to California consumers of $7.7 million; to pay a monetary penalty to the State of California of $5.4 million; and to reimburse the California Department of Insurance $175,000 for the costs of the investigation.

First American Title Insurance Company and First American Reinsurance Company entered into similar agreements with the Department and agreed to pay $15 million in restitution to California consumers and a $4.8 million monetary penalty to the State of California. They also agreed to reimburse the California Department of Insurance $175,000 to cover the costs of the investigation.

Commonwealth Land Title Insurance Company, Lawyers Title Insurance Corporation, Transnation Title Insurance Company, and LandAmerica Reinsurance Services, Inc. have not resolved their issues with the California Department of Insurance.

California consumers who purchased, sold, or refinanced their homes between January 1, 1997 and December 31, 2004, by and through mortgage lenders, homebuilders, or real estate brokers who were engaged in a captive title reinsurance arrangement with Chicago Title Insurance Company, Fidelity National Title Company, Fidelity National Title Company of New York, Security Union Title Company, Ticor Title Company, FNF Reinsurance Company, First American Title Insurance Company, or First American Reinsurance Company will receive refunds directly from the title companies.

The refunds average over $300. The title companies will provide the Department of Insurance a list of those California consumers who are eligible for a refund. The Department of Insurance will investigate those lists for compliance. Consumers who wish to determine if their mortgage lender, homebuilder, or real estate broker participated in a captive title reinsurance arrangement with any of the title companies identified in this article, should check the July 20, 2005 press release on the California Department of Insurance Web site at **www.insurance.ca.gov.**

In California, title insurance is required by mortgage lenders. The average premium on a title insurance policy is over $1,400. Consumers rely on their mortgage lenders, homebuilders, and real estate brokers to obtain title insurance at the lowest possible cost.

However, these captive title reinsurance schemes illustrate that many times consumers were not referred to the title insurer with the lowest possible cost, but rather to the title insurer providing the best possible kickback. As a result of the captive title reinsurance schemes, the California Department has expanded its examination of the title industry to determine if the rates charged for title insurance are excessive.

In conjunction with other state insurance regulators, California state agencies, and federal agencies, the California Department of Insurance continues to pursue examinations, investigations, and prosecutions of title companies engaged specifically in captive reinsurance arrangements, and generally in illegal rebate activities.

** "Title insurer" means any company issuing title policies as insurer, guarantor, or indemnitor. "Underwritten title company" means any corporation engaged in the business of preparing title searches, title examinations, title reports, certificates or abstracts of title upon the basis of which a title insurer writes title policies. "Controlled escrow company" means any persons, other than a title insurer or underwritten title company, whose principal business is the handling of escrows of real property transactions in connection with which title policies are issued.* ■

Rebecca M. Westmore is Senior Staff Counsel for the California Insurance Department.

Insurance brokers

Drive for disclosure casts old practices in new light

by Joseph S. Harrington, CPCU

The irony of Eliot Spitzer's impact is that there is nothing surprising about the business practices some seek to regulate in the wake of his investigations, and laws and regulations have long been in place to address the abuses that did catch people by surprise.

Bid-rigging is clearly illegal, but many insurance professionals were initially at a loss to explain the fuss over contingent commissions, which most insurance buyers and sellers have long been aware of and accepted.

In particular, many commercial buyers regarded contingent compensation for their brokers as a way to save themselves money and be rewarded for loss control.

However the legal battles work out and the final regulations are written, the New York attorney general has put insurers and their trade associations in an awkward situation: How do they resist growing demands for disclosure of producer compensation without appearing to resist the idea of disclosure itself?

A culture of disclosure has taken hold in American business over the past 30 years. As restrictions on what businesses can do have been relaxed, requirements and expectations that they disclose what they do have grown.

Today, pharmaceutical companies spend 45 seconds of a commercial telling you how a drug can help you, and abruptly shift gears to spend the final 15 seconds describing how it might harm you.

Support for the idea of disclosure crosses cultural and political lines and has become heavily ingrained in business ethics.

"Even if disclosure is optional for agencies, it may become a 'best practice' for independent agencies" says Darin Kath, chief operating officer of Jewelers Mutual Ins. Co., Neenah. Wis.

"An educated consumer is the best protection against abuses," said Kristina Baldwin, a representative of the Property Casualty Insurers Association of America (PCI), at a New York hearing.

Yet Baldwin felt compelled to caution against "overreaching or burdensome proposals that fail to deliver any real value to consumers."

Who's paying?

The reflexive expectation of disclosure became evident when the National Association of Insurance Commissioners (NAIC) responded almost immediately to the Spitzer investigations with a proposal to require insurance agents and brokers to disclose the source and amount (or method for determining the amount) of their compensation for each transaction.

While most states waited for the NAIC to finish work on the proposal (drafted as an amendment to the NAIC's Producer Licensing Model Act), at least two--California and Oregon--pressed ahead with regulations of their own to require increased disclosure of compensation by agents and brokers.

Trade associations representing agents, brokers, and carriers responded in turn that the proposed disclosure requirements were too broad and would prove to be unwieldy.

They fear that producer compensation disclosure requirements will be extended to all insurance purchases, while the Spitzer investigations have found problems primarily in commercial transactions where the producer is receiving compensation from two different sources, creating potential conflicts of interest.

"If both the insured and the insurer are compensating the producer, then a disclosure requirement is appropriate," reads a statement from the Association of California Insurance Companies (ACIC).

"There is no need for disclosure in the 'agent' situation, where the insurer pays the producer and the producer is not directly compensated by the insured," it continues.

That probably won't satisfy consumer advocates, however.

Birny Birnbaum, executive director of the Texas-based Center for Economic Justice, told an NAIC panel that anything less than full disclosure by all producers for all lines will "encourage sellers to game the system and shift from one form of disclosed compensation to another."

Even industry advocates concede it is often difficult to distinguish between agents and brokers.

"Agents often act as brokers, brokers often act as agents," says Julie Rochman, senior vice president for public affairs for the American Insurance Association (AIA). "It's not easy to differentiate."

For that and other reasons, insurance trade associations are promoting "transaction-based disclosure," wherein disclosure would be required only when the producer receives compensation from both the buyer and the insurer.

Wrong focus?

Rochman and others insist that a blanket disclosure requirement would not necessarily be helpful to insurance buyers seeking to determine if they are getting the best available coverage for what they are spending.

"Disclosures must disclose information that is meaningful to customers, not disclosures for disclosure's sake," she says.

"We have seen a number of ideas that sound good conceptually, but they provide absolutely no value to the consumer in obtaining a good product [and] a good price," said Robert Rusbuldt, president of the Independent Insurance Agents and Brokers of America (IIABA) in a December statement.

A general disclosure requirement on agents "adds burden without value," says Peter Bisbecos, director of legal and regulatory affairs for the National Association of Mutual Insurance Companies (NAMIC). "It could almost be a distraction."

As the last comment suggests, carriers and agents are apprehensive that disclosure requirements may make it harder to sell insurance.

Whether it contributes to making an informed choice or not, a disclosure interjected into a transaction can change the dynamics of a marketing encounter, says Ann McGill, professor of management, marketing, and behavioral science at the University of Chicago Graduate School of Business.

Whatever its content, a disclosure statement often creates apprehension among consumers, especially when it is delivered orally. "A common reaction is to ask 'Why did he say that? Is there something wrong?'" says McGill.

"If commission disclosures become common, deals will become more focused on price," says Chris Burand, president of the consulting firm Burand & Associates, Pueblo, Co ., and a regular columnist for American Agent & Broker magazine.

"Companies with the lowest prices are generally the weakest," Burand says. "I fear that more and more insureds will be placed with weak carriers."

Life insurance agents have expressed "grave concern" about the marketing impact of compensation disclosure requirements, says Robert Zeman, senior vice president for industry affairs for the PCI.

"How much it will affect sales on the P&C side, I doubt that anyone knows," he says. "But if there's a general requirement to disclose [the amount and] sources of commissions, that gets close to divulging trade secrets."

Industry spokesmen worry that automatically disclosing commission amounts will create unwarranted suspicions of a producer's recommendations, but consumer advocates argue that such suspicion is warranted.

"When a consumer is offered an insurance product and sees . . . compensation equal to 40% to 70% of the total premium," said Birnbaum in his statement, "that consumer will reasonably question the value of the benefits in relation to the cost."

Unpredictable

Sources for this article doubt that compensation disclosures will shift many personal lines customers from a "bottom line" orientation toward buying insurance, although there will be awkward moments if producers are, in essence, forced to disclose how much money they make on a transaction.

Even if insurers succeed in limiting disclosure requirements to situations where brokers receive compensation from two sources, the entire tone of industry marketing may have to change.

If companies opt to emphasize the role of agents as representatives of the carrier to avoid disclosure, how does that impact the use of "good hands," good neighbor," "trusted choice," "we're on your side," and other marketing messages designed to give consumers confidence that sales representatives have their interests at heart?

The potential impact on commercial lines is even more unpredictable.

continued on next page

Drive for disclosure casts old broker practices in new light

continued from preceding page

"For agencies with strong commercial customer relationships, commission disclosure will be no problem at all," says Burand. "For agencies that sell based on price, it's a big deal. Those agencies are beside themselves. They're panicked."

Increased disclosure could result in "a reduction in the number of carriers an agent represents for a class of commercial business," says Kath at Jewelers Mutual.

"If an agent has to substantiate that he placed a client with the best possible program, it may be safer to place business exclusively with markets that specialize in each type of risk, such as contractors, machine shops, and so forth," Kath explains.

It follows, according to Kath, that if agents restrict the number of markets they use, more agency contracts will be terminated.

Agency operating costs may come under pressure if large accounts start to question commission levels, says Rick Maka, AAIS director of marketing, who previously spent years as a producer and manager for an Aon subsidiary.

According to Maka, carriers typically earn larger margins on large account commissions. This subsidizes, to some extent, the costs of acquiring smaller margin accounts. As disclosure opens those commissions to increased scrutiny--with or without formal disclosure requirements--agencies and brokerages can expect large accounts to bargain harder.

Reinsurance

Just as the controversy over disclosure spread quickly from commercial brokerage into personal lines, its impact also extends to the reinsurance market, long considered the province of insurance and risk management professionals who understood each other's language and did not require consumer protections.

But, Guy Carpenter, Marsh Inc.'s reinsurance brokerage subsidiary recently went public with a "Disclosure Doctrine" on reinsurance treaty placement.

In the document (available at www.guycarp.com), Guy Carpenter states guideline rates for brokerage of pro rata placements, excess of loss placements, London excess of loss placements, and reinstatement premiums.

The document also announces the termination of a "limited number" of market agreements wherein reinsurers made payments to Guy Carpenter. "These agreements, in the aggregate and in any one year, represented a very small percentage of Guy Carpenter's total revenue," the statement reads.

Reinsurance professionals contacted by this author say contingency fees have been relatively rare in reinsurance brokerage, and that the rates charged for different types of cessions are standard throughout the industry.

If the major reinsurance brokerages foreswear contingency fees entirely, however, it could put pressure on them to establish or increase fees for risk management and loss control services that direct writer reinsurers typically roll into their rates.

The idea of disclosure is so appealing, and hence so hard to resist, because it is often presented as an agreeable alternative to prohibitions on certain practices.

Yet, the impact of generalized disclosure requirements can have as profound an impact on insurance carriers as a direct prohibition on methods for marketing or pricing coverage.

If agents are regularly required to disclose the source and amount of their compensation, it will become much easier for one's competitors to learn a company's producer compensation strategy.

Beyond that, carriers can anticipate that new disclosure requirements will drive expectations and demands for even more disclosure requirements.

In the era of disclosure, silence is not golden. ■

Joseph Harringon is the Director of Corporate Communications for the American Association of Insurance Services, Wheaton, Illinois. This article

originally appeared in the Winter 2005 edition of *Viewpoint*, published by the American Association of Insurance Services (AAIS). AAIS is a national advisory organization and statistical agent that develops policy forms and rating information used by more than 600 property/casualty companies throughout the U.S. For more information, go to www.AAISonline.com.

Preparing for the market conduct examiner

by Bob Chilone

Compliance with state insurance laws and regulations is an attitude and approach that begins immediately upon the company's underwriting of the risk, continues throughout the rating, quoting and policy issuance process and remains in effect for as long as policies are in-force. It's not an after-thought that can be handled as part of the underwriting process, but a distinct review of the regulatory and processing aspects of producing business. Conducting routine audits and self-assessments are the only proactive ways an insurer can control the situation and be fully prepared and confident the day the examiner arrives.

There is a general perception that both the underwriting process and the corresponding underwriting audit significantly contribute to a company's results. A company's underwriting audit is conducted to determine and ensure that exposures are written in accordance with underwriting guidelines at prices that produce profitability. Reviewing the procedural and processing aspects of the insurance transaction does not necessarily yield immediate benefits for the company.

Insurance company compliance departments are not profit centers, and can be viewed by the company as a roadblock to doing business. However, if the company compliance department provides a full array of services, including regulatory and processing audits, they can significantly enhance a company's position and reputation in the marketplace and play a key role in the reduction of fines and penalties.

Many companies believe the underwriter can review compliance issues during the course of the underwriting audit. This is not true. Just as there are specific components to an underwriting audit (i.e., risk appetite/selection, price and profitability), there are distinct factors to consider when conducting compliance audits. The focus is different and there is a need to determine these factors by individuals trained to identify them, in other words, a separate set of eyes that are neither directly associated with nor influenced by the profitability of a particular book of business.

There are three main ingredients to a compliance audit. They are: 1) the regulatory review, 2) the operational review and 3) the producer review and together they complement the facets of a state insurance market conduct examination.

The regulatory review should concentrate on the statutory obligations of the company with respect to the initial issuance and subsequent servicing of new business and renewal policies including, but not limited to, adherence to filed and approved rates, rating plans and forms, completed applications, binders, certificates of insurance, cancellation/nonrenewal and other mandatory notices, option selection/rejection forms, countersignature and schedule rating worksheets and documentation.

The operational review should consider the processing timeframes associated with the issuance of declinations, quotations, policies, any type of mid-term change and premium audit (if applicable), both for new business and renewal policies.

The producer review should include the status of resident and non-resident licenses and their corresponding lines of authority, the entire appointment process with state insurance departments, including background investigations and signed producer agreements, broker and agent compliance with the terms, conditions and other contractual obligations of the signed agreement and any affiliations with sub-producers. A more thorough review may also include an evaluation of the office workflow, security procedures and disaster recovery plans.

Getting control of the process from the beginning enables the company to significantly minimize, if not virtually eliminate, any repercussions from market conduct examinations. By being diligent in its efforts to conduct self-assessments of its operation, the company can provide more organized documentation and make the market conduct examination less difficult.

Audits conducted by the company should conclude with an oral discussion of all findings and a written report that clearly identifies each potential violation and contains remedies for each situation. This report can be helpful to the state insurance department examiner. However, one important factor must be considered. Conducting the audit and writing the report by the company is not enough. Periodic review and follow-up must take place to confirm those issues identified have been appropriately addressed and/or corrected, otherwise, the process merely becomes a documentation of violations. ■

Bob Chilone has over 32 years of insurance experience with several national companies in the area of regulatory affairs and compliance. He is a consultant with K. Robi & Associates, LLC, a firm that provides customized assessment services for the property/casualty insurance industry.

Letter to the Editor

Dear Editor:

This is in response to the letter from Doug Stolte (November Regulator) in which he complained about your coverage of the panel on service contracts at last summer's IRES CDS. Unlike Mr. Stolte, I thought your coverage was fair.

Mr. Stolte took issue, during the panel and in his letter, with my statement that only Virginia treats home service contracts as insurance by statute.

Here are the facts:

FACT: Only Virginia does. I provided a full, authoritative citation to all 50 state statutes. I have provided it to Mr. Stolte. I will provide it to anyone for the asking.

FACT: Mr. Stolte has never been able to cite one statute, one state or one authority for his position.

The NAIC adopted the "Service Contract Model Act" in 1995 that treats service contacts as a noninsurance product.

FACT: Read the NAIC Model Service Contract Act. Every state has a copy.

When the NAIC adopted the Service Contract Model Act in 1995, the Committee Chairman directed that a drafting note be added to state the committee had concluded, "that service contracts are not insurance."

FACT: Anyone can check this. Go to Proceedings of the NAIC, 4th Qtr, December 4, 1995, p. 1027 and read it.

The same NAIC committee minutes were adopted by the full NAIC Plenary a few days later.

FACT: It was adopted. The adoption stands today and has never been repealed. Citation: Proceedings of the NAIC, 4th Qtr, 1995.

The adoption of the NAIC Model Service Contract Act and the NAIC Service Contracts Model Act Subgroup represents the formal policy of the NAIC on the topic.

FACT: This is exactly how the NAIC adopts positions. Always has been. NAIC confirmed this on its web site.

"Each committee produces minutes describing the issues discussed and actions taken. A panel's conclusions and decisions on a subject may lead to the development of a new regulatory approach, model law or model regulation. If a model is adopted by the plenary, it becomes a formal NAIC recommendation of regulatory policy to each member."

Interesting is that NAIC has apparently since removed the statement but such does not change the facts or NAIC history. We have a copy for anyone who wants it.

Since 1995, 25 states have changed their laws or adopted new ones that treat home service contracts as non-insurance products.

FACT: 1995 is not 2005. The misleading letter Mr. Stolte reportedly demanded that NAIC General Counsel Andy Beal produce only suggests the status of the law in 1995, not 2005. It reflects that Mr. Beal was unable to find the NAIC Model Service Contract Act adoption or NAIC Committee report adoption. We found it easily. We cite it above. It's on every shelf at the NAIC and in every state insurance department. Mr. Beal's letter was political, not factual.

In law school I learned a wise saying "In God we trust. All other authority must be cited to line and page number." I follow that. Just the facts.

Arthur J. Chartrand
IRES Member

Mr. Chartrand is a Kansas City attorney and national regulatory counsel to the National Home Service Contract Association.

EDITOR'S RESPONSE: *This will be the final letter on this subject to be published in* The Regulator. *However, we encourage readers to submit letters to the editor on any other subject. We also encourage any* Regulator *reader who knows of any state other than Virginia that regulates home service contracts as insurance to let us know, and please include all relevant statutory or regulatory citations.*

C.E. News

IRES Accreditation update:

LOMA no longer lists Academy for Healthcare Management on its list of courses LOMA offers. However, the AHM courses are still being offered by the Academy and are still included in the IRES accreditation curriculum. To obtain course information for AHM 250, AHM 510 and AHM 530, contact:

Academy for Healthcare Management
601 Pennsylvania Ave. NW
South Building, Suite 505
Washington, DC 20004
800-667-3133
www.academyforhealthcare.com

IRES member dues notices were mailed out in late December. Please make sure you pay your dues by February 15.

N·I·C·E
National IRES Continuing Education
The mandatory continuing ed program for AIE and CIE designees

“ Quote of the Month ”

“I have no idea what the hell that man’s problem is.”

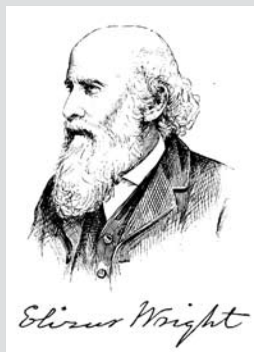
— Former AIG Chairman Maurice “Hank” Greenberg, responding to charges by NY Attorney General Eliot Spitzer that he had short-changed the estate of AIG founder, Cornelius Vander Starr, more than 30 years ago.

Casual Observations

Born To Regulate

We're a little late, but we'd like to offer belated 200th birthday wishes to Elizur Wright, born on February 12, 1804. (What's two years when you're celebrating two centuries?)

A self-made actuary and Yale math major, Wright has been dubbed the father of modern life insurance as well as the father of legal reserve life insurance. Given our druthers, we'd call him the father of nonforfeiture benefits.



These days most of us don't give much thought to nonforfeiture benefits, such as extended term, reduced paid-up and cash surrender. In Wright's day, however, life insurance policyholders who could no longer afford their premiums had few alternatives. One thing was certain: life insurers never bought back policies.

The inherent inequity of this system was brought home to Wright in 1844 during a trip to London where he first heard life insurance described as "the greatest humbug in Christendom." Curious as to why an industry to which he had devoted so much of his life could be so viciously disparaged, Wright was directed to the weekly auction in London's Royal Exchange.

Peter Lencsis in his December 2005 *Best's Review* article, "Annual Checkup," vividly captures the auction scene. There, says Lencsis, policyholders who no longer could afford their premium payments would exhibit themselves to prospective bidders. The gallery could then assess each insured's health for themselves and bid for their life policies. The sickliest looking, of course, would most likely fetch the best price.

Wright, an ardent abolitionist, likened the practice to slave auctions he had witnessed in America and left England determined to prevent such degradation taking root in the United States.

His crusade led to the enactment of meaningful nonforfeiture laws in Massachusetts and other states. In 1858, Wright was appointed Massachusetts Insurance Commissioner and continued to fight for the rights of policyholders during his eight-year tenure.

Some claim that Wright's mandated nonforfeiture cash surrender values created a monopsony, a market characterized by multiple sellers and only one buyer. That's true, but Wright's cash surrender values were actuarially sound and strictly regulated. He also helped millions of down-on-their-luck insureds receive fair value for their life insurance policies.

Wright's reforms changed the face of the modern life insurance policy. Only in the last part of the 20th Century, with the advent of AIDS, did a viable secondary market for life insurance policies reemerge.

Elizur Wright believed that a policyholder who pays a lifetime of premiums should never fall victim to the auctioneer's capricious gavel. Few insurance regulators can have the impact of an Elizur Wright, but *every* regulator is capable of making a difference.

— W.C.

CHICAGO

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AUGUST 6-8, 2006 HYATT MCCORMICK PLACE

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Your mailing address Indicate: ☐ Home ☐ Business

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Seminar Fees

(includes lunch, cont. breakfast and snack breaks for both days)

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- ☐ IRES Member (regulator)..............$305
- ☐ Industry Sustaining Member.........$495
- ☐ Non-Member Regulator...............$440
- ☐ Retired IRES Member...................$120
- ☐ Industry, Non-Sustaining Member..............................$765
- ☐ Spouse/guest meal fee...................$80

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Hotel Rooms: You must book your hotel room directly with the Chicago Hyatt McCormick Place. The room rate for IRES attendees is $150 per night for single-double rooms. Call group reservations at 800-233-1234 or 312-567-1234. The IRES convention rate is available until July 6, 2006 and on a space-available basis thereafter. Our room block often is sold out by early June, so guests are advised to call early to book rooms. See the hotel's web site at http://www.mccormickplace.hyatt.com To book a room online at the Hyatt site use Group Code G-REGS

CANCELLATIONS AND REFUNDS

Your registration fee minus a $25 cancellation fee can be refunded if we receive written notice before July 6, 2006. No refunds will be given after that date. However, your registration fee may be transferred to another qualifying registrant. Refund checks will be processed after Sept. 1, 2006.

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If registering after July 6, add $40.00. No registration is guaranteed until payment is received by IRES.

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SPECIAL DIETS: If you have special dietary needs, please circle: Diabetic Kosher Low salt Vegetarian

Seating for all events is limited. IRES reserves the right to decline registration for late registrants due to seating limitations.

Call for more details: 913-768-4700. Or see IRES web site: www.go-ires.org

BULLETIN BOARD

√ Want to write a guest article for *The Regulator*? Email the editor at quepasa1@ optonline.net.

√ Due to space limitations, our "Regulatory Roundup" feature will not appear in this issue. It will return in the March issue.

√ Regulators were shocked and saddened to learn of the untimely death of Lewis Shayne, an active IRES member. An obituary for the longtime New York insurance examiner appears on p. 8.

In the next REGULATOR:

BIRNBAUM ON TITLE INSURANCE

LOWERING PRIVATE PASSENGER AUTO RATES

Welcome, new members

Richard L. Acampora, VA
Laura S. Adler, VA
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Mark Noller, MA
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The Katrina nightmare

for insurance regulators

See story, P. 1

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