The Regulator®
INSURANCE REGULATORY EXAMINERS SOCIETY

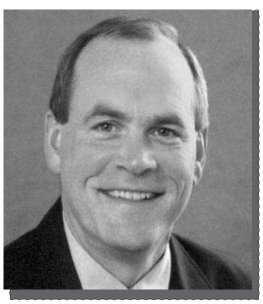
Health Insurance Regulation in the Obama Administration

Where Do the States Fit In?

by Steve Tuckey
Special to *The Regulator*

Joel Ario spent the first part of the decade overseeing the Oregon insurance market while guiding development of a new market conduct regime under the auspices of the National Association of Insurance Commissioners (NAIC). Today, as Pennsylvania commissioner, Ario has been thrust into the maelstrom of the health care reform debate that is sure to grow in intensity as the Obama Administration and Congress march toward the ultimate goal of universal coverage.

As chairman of the Health Care and Managed Care "B" Committee, Ario sees his work this year in its traditional state-oriented role of helping to ensure small businesses and individuals have access to affordable health care, as well as serving in partnership with Congress and the Administration to develop a new health care delivery system.


Ario of Pennsylvania

Even Ario's traditional state-oriented duty will require an intense interaction with the federal government. "The individual and small group markets continue to be challenging in most states," Ario said. "They don't have the advantage of national pooling that you get with large groups so most states have some form of pooling."

Such pooling, Ario said, can consist of rate bands or restrictions on what rating factors can be used, or other mechanisms like high-risk pools to provide people with the opportunity to get into larger pools who otherwise would not be able to because of their health status. State laws vary, but small groups are usually defined as those including businesses of 2 to 50 employees, Ario said.

In 1996, Congress passed the Health Insurance Portability and Accountability Act (HIPAA) which, among other things, requires insurers writing small group insurance to guarantee coverage to all small groups. "What Congress did not do, however, was set the rules on how that coverage was priced, so that is still a state-by-state matter," he said.

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Lessons from the Mortgage Meltdown

A Cautionary Tale for P/C Insurers

by Brian Sullivan

Let's take stock of what insurers can learn from those early days of mortgage madness. The most important lesson is that you can't suspend the natural laws of money. You can't turn iron into gold. Spending more than you make eventually empties your wallet. Lending money to people who can't pay it back always ends badly. Borrowing at 10% and lending at 5% is a money-losing proposition that can't be fixed by gambling with what little money you have left.

All of these natural laws can be defied for a time. Indeed, you can jump into the air, rising from earth in defiance of the gravity, but unless you have a Saturn 5 rocket on your back, at some point you're going to come down to earth. And the higher you jump, the more difficult it becomes to land safely.

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From the President

Take the IRES Benefits Quiz

Over the last several months, I have had the opportunity to talk and exchange e-mails with many IRES members. During these exchanges, I have noticed that a fair number of members, new and seasoned alike, are not aware of the many new benefits IRES has launched in the last couple of years.

I have also noticed that quite a few members do not know about the many features available on the IRES Web site. The only explanation I can think of is that IRES has not been doing enough to let its existing members and potential new members know all that we have to offer.

So, how much do you know about the benefits of being an IRES member?

The IRES Benefits Quiz

Did you know that . . .

- IRES General members qualify for educational discounts for services and/or products offered by LOMA, the American Institute for CPCU (AICPCU), the Insurance Institute of America (IIA) and the Insurance Data Management Association (IDMA). The discounts are as high as 50% off the regular price.

- IRES has contracted with a full service travel agency to provide competitively priced travel-related services to all our members for business or personal travel. Under the agreement, IRES members may choose to book their own travel through an online booking service provided by the travel agency or contact the agency directly to have a travel specialist make all arrangements.

- The Members Area of the IRES Web site has an online membership directory. By simply entering a name, you can instantly find membership and employment status.

- If you hold an AIE or CIE, you can view the number of continuing education credits that you have reported to IRES.

- You can let IRES know what information you want to receive from IRES and the format in which you receive it. For example, you can elect to be notified via e-mail when *The Regulator* has been posted online in lieu of receiving hard copies of the publication.

- Through the Members Area you have access to every article from every issue of *The Regulator* since 1998. In addition, our comprehensive search function allows you to seek out articles by topics or key words.

- You can register online for the CDS.

- Via the Members Area of the Web site you can see your IRES contact information and notify IRES when your information changes.

- You can volunteer to work on IRES Committees and Subcommittees by updating your profile in the Members Area of the Web site.

- You have access to job postings, committee meeting minutes, the IRES budget, and much more via the Members Area of the Web site. (Incidentally, if you've forgotten your Members Area password, call Susan Morrison at the IRES office or e-mail her at ireshq@swbell.net.)

If you answered yes to most of these questions, good for you! You are well positioned to take advantage of all the benefits your IRES membership has to offer. Plus, you can help get the word out by telling your colleagues about all these perks of membership.

If your answer was no to many of the questions and you want to learn more about these benefits, please visit the IRES Web site (www.go-ires.org). If you don't find the information you are looking for, please contact me at jo.leduc@wisconsin.gov or (608) 267-9708.

Jo A. LeDuc, CIE, MCM
IRES President

Welcome, new members!

Bob Baker, OH
Emilie Brady, MA
John Burkholder, KY
Ryan Havick, unaffiliated
Anne Lindenberg, MN
Joe F. Musgrove, AR
Douglas Slayten, IN
Jay Thompson, AIE, KY

Where does state regulation fit in?

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Unregulated pricing could defeat the purpose of guaranteed issue because a group with bad experience could be rated so high as to be priced out of the market. "So that is why some states have put in pricing reforms that spread the risk more effectively," Ario said.

New federal initiatives

Improvements on small group pricing models hinge on what steps Congress takes this year in overall health care reform. And that raises the issue of the first of what could be a number of health care proposals issued late last year.

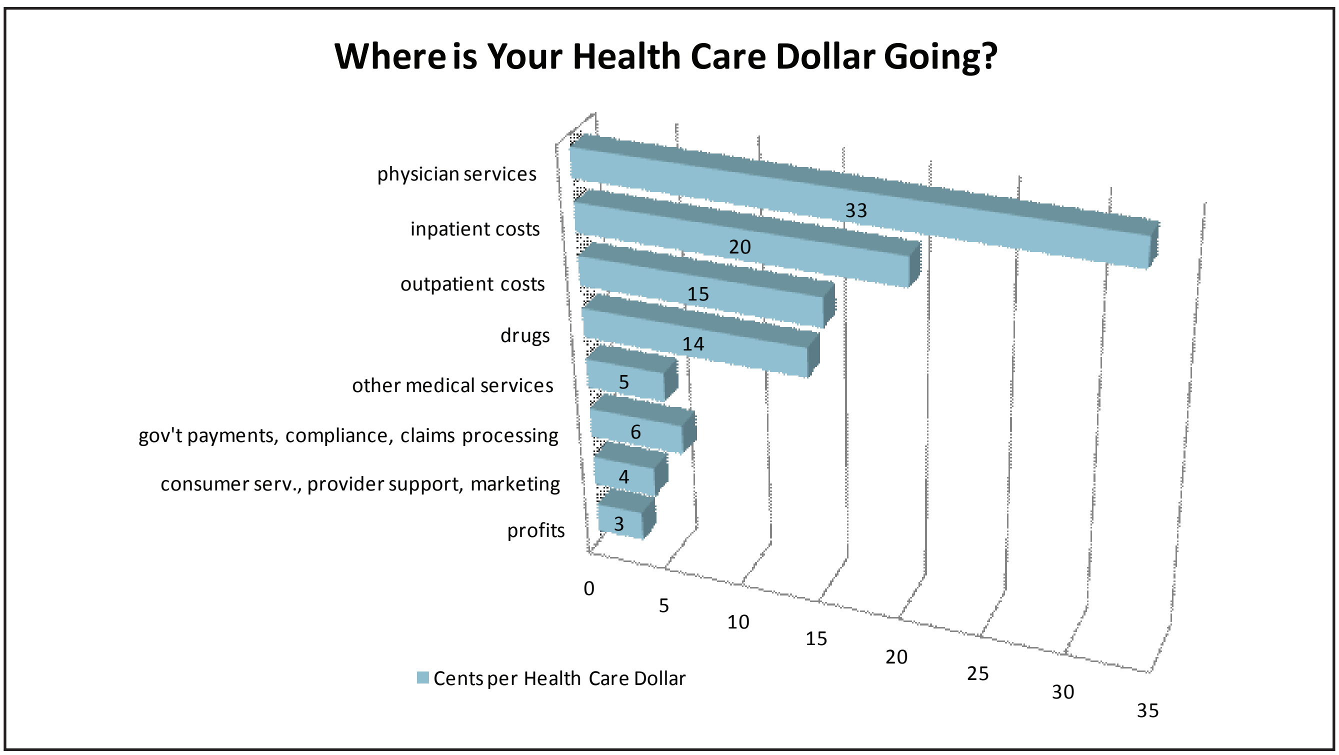
In December, Senate Finance Committee Chair Max Baucus (D-Mont.) proposed in a detailed 87-page plan a national insurance exchange open to individuals and small businesses that could work like cafeteria plans do for large businesses in which various health care packages are available to all participants regardless of health status or age.

"So the question is what the rules for that exchange are, and this is where the NAIC will provide input," Ario said. So far, plans are for a ban on rating based on health status or age, much like what exists in large company plans today. "If you get a rate for a large business by federal law you have to treat all employees the same, so that is essentially a community rate," Ario said.

But so far, only five states have said the small group market should be community-rated while other states permit bands that allow charging groups that have older workers higher rates, but only within a certain rate band. "I think what is generally envisioned is rating rules which would make the small group and individual market work more like the federal insurance pool or other cafeteria plans that are not rated on experience but more like a community rate," Ario said.

No deadline has been set for any recommendation and the rating rules section of the Baucus plan has been left open for the indefinite future while groups provide input.

One question regarding the plan, which is similar to one Obama discussed during his campaign, becomes whether any exchange rating rules would preempt state rules in order to conform to the new federal requirements. Adverse selection could result from any difference in strictness of rules, Ario said, because



Source: PricewaterhouseCoopers Cost Study, 2008 sicker individuals could be attracted to less-stringent plans.

Guaranteed coverage

Another question centers on whether participation in the pool would be mandatory, along the lines of personal responsibility laws in many states that require car owners to purchase basic automobile insurance coverages. The health insurance industry in November backed guaranteed coverage requirements regardless of pre-existing medical conditions with the proviso that such proposals include mandatory participation.

Karen Ignani, president of the Washington, D.C.-based America's Health Insurance Plans, a national association of health insurers, said guaranteed coverage mandates often work against consumers because insurers will raise prices to cover the cost of chronic illnesses that arise under guaranteed coverage. She cited a Milliman study that shows guaranteed coverage laws (without pre-existing condition waiting periods) encourage people to wait until they have health problems before seeking insurance, thus raising the costs for all customers.

BlueCross BlueShield Association president Scott Serota made much the same point while applauding the Baucus proposal to establish a Health Care Comparative Effectiveness Research Institute as a good step to more evidence-based medicine. Under the proposal, the Institute would review evidence of various health care treatments and determine the most appropriate approaches.

A Santa Monica-based consumer group, Consumer Watchdog, took a different view of mandatory participation laws. They believe such an approach would, in essence, codify a federal delivery system to a wasteful private health insurance industry, and instead urged the Obama Administration to consider opening Medicare coverage to people of all ages.

"It will not solve the nation's health care problems and will only encourage the industry to demand higher premiums and more taxpayer subsidies while providing less health care," said Jerry Flanagan, the group's health care policy director of mandatory coverage provisions. Such a mandate, opposed by President-elect Obama during the campaign, could end up providing "junk" coverage with huge deductibles and high costs, Flanagan added.

Those are among the many opinions "B" Committee members, and ultimately the entire NAIC body, will have to take into consideration as the health care debate gets into full swing this year.

The states' role

Enactment of the Baucus proposal or any federal health care overhaul would not leave states totally bereft of any role in the process. "There will still be all kinds of issues like individual filings, particularly if there is flexibility within the rate band so there will still be state-regulated health insurance," Ario said. The Baucus proposal could end up competing with other proposals. Or all such plans could fall by the wayside if the current economic crisis becomes so serious that it preempts any serious look at a problem so complex and fraught with the competing interests of so many groups. In essence, a repeat of 1993 when Hillarycare went down in flames.

"The fallback option I hear discussed most often is giving the states more flexibility, and maybe some resources to support pilot projects in states to test different kinds of ideas," Ario said. Top on the agenda is a serious look at the Massachusetts system based on individual mandates. "And maybe another state could try switching from an employer-based system to an individual system," said Ario.

Another popular concept is "play or pay" in which employers have to either provide coverage or pay into a system that provides it on a universal basis. Such a plan would eliminate the competitive advantage for those employers who fail to provide coverage, Ario said.

If the federal government does not act in the health care arena this year, Ario said "B" Committee regulators will have numerous options such as reinsurance pools and high-risk pools to look at and encourage in some form, providing they seem effective.

While the Optional Federal Charter (OFC) proposal that the NAIC has so vigorously opposed over the years for the threat it poses to state regulation seems to be off the table for the current year (see article, p. 6), regulators today appear to accept a more vigorous federal role in health care regulation and want a place at the table as that role comes to fruition. ■

OFC Proposals May be Low on Many 2009 Wish Lists

While the main Washington-based property/casualty and life insurance lobbyists will continue to push for an Optional Federal Charter (OFC) this year, indications are that the item may not top the wish lists of Congress and the incoming Obama Administration.

Blain Rethmeier, senior vice president of public affairs for the American Insurance Association (AIA), said that "with insurance being a key industry within the financial services arena, we fully expect regulatory reform and an Optional Federal Charter to be a part of the discussion out of the gate."

But he added that "we don't know exactly what form the new regulatory environment will take given the current economic crisis."

In a similar vein, the American Council of Life Insurers (ACLI) will not let up in its effort to create the federal regulation option.

Steven Brostoff, associate director of media relations for the ACLI, said that "when life insurers asked to be included in the Capital Purchase Program under a Troubled Asset Relief Program, it became evident to Treasury Secretary Paulson it would be difficult to do absent a federal regulatory presence."

No decision has been made as to whether life insurers will be a part of that program, Brostoff said.

In a story published by the *National Underwriter* early last month, Sheila Bair, Chairman of the Federal Deposit Insurance Corporation, was said to have told the AIA representatives in a confidential briefing that plans to create a federal charter may fall by the wayside in Congress as the Administration seeks to consolidate regulatory agencies, not create new ones.

Bair was quoted in the off-the-record briefing as saying that creation of a separate federal agency to regulate insurance would create the kind of turf war among federal regulators that the administration will seek to avoid.

She also said that regulatory priorities for the new administration will focus on credit default swaps and mortgage-backed securities that have been at the heart of the current economic crisis.

In addition, the fact that the property/casualty industry is not in any trouble now and is regulated by the states will work against any moves to create new federal oversight.

Rethmeier would neither confirm nor deny the veracity of the report, saying only that the meeting was closed and therefore he could not comment.

Non-existent prospects

Roger Sevigny, the New Hampshire insurance commissioner and president of the National Association of Insurance Commissioners, called prospects for an OFC in 2009 "non-existent," saying it would make no sense in these economic times.

But he did see the creation of some sort of federal systemic risk regulator this year who would work closely with state insurance regulators.

That same *National Underwriter* report also quoted a prominent life insurance lobbyist as saying that OFC will not top the Congressional agenda and other lobbyists as saying that the life insurance industry will go back to the drawing board to determine which banking agency would be the most appropriate to regulate it.

For the past several years the life insurance industry as a whole, and portions of the property/casualty industry, have urged creation of the federal option to eliminate the duplicative costs stemming from 50 separate regulatory entities.

But they have run into opposition from state regulators for numerous reasons including the fear that consumers would have difficulty addressing grievances to federal regulators as opposed to state-based ones. ■

— *Steve Tuckey*

Prevent the Next Crisis: Demand Risk Management Education

by Etti Baranoff

Our financial celebrities and biggest Wall Street earners have long been identified by their ability to generate windfalls. In the midst of our present dire circumstances, a key question emerges: Shouldn't we place the same star status on those who prevent disaster?

Does it astonish anyone, in light of the mess we have seen on Wall Street, that most business schools do not require students to take risk management classes? Is it remotely surprising that graduates of most university programs never learn a valuable shred about how to manage risk?

> ***"Does it astonish anyone . . . that most business schools do not require students to take risk management classes?"***

Many of these grads are the financial wizards who have brought us credit default swaps and mortgage-backed securities. It is clear that these innovative minds and their managers delivered risky products to the financial markets without risk management actions.

Why? Perhaps because they did not have the opportunity to learn the art of managing and mitigating risks. They created the bundling of mortgage-backed securities as towers of cards. The bottom card – the quality of the borrower – was insufficiently checked, underwritten or verified. The card was pulled away, and the tower crumbled.

Was it willful blindness? No. Smart people would never undertake such risks voluntarily. It was ignorance.

These technicians, the Wall Street modelers who arrived from the quantitative fields to change our financial landscape, used risk measures in their pricing of new financial instruments, but that was far short of sufficient. They did not play the devil's advocate's role and do a genuine scenario analysis, which is central to an effective evaluation. Even worse, they did not create risk mitigation tools for avoiding collapse. Neither did their managers and regulators, who did not know what questions to ask.

What we saw was the following: In finance and asset accumulation and management, no underwriting took place. Mortgages were given to the unqualified. Underwriting of risks ceased to exist. Banks and mortgage companies did not behave cautiously. Some ceased to even utter the word underwriting, as if it was a term that belonged only to insurance. The operators who bundled these mortgages did not check the premises of the bundles.

So little basic prudence for such high stakes.

With all of the emergency solutions and the political haggling designed to avert a possible depression, the biggest call for clarity of our future should be: Demand and ensure that our educational institutions teach the capacity to understand risks and the tools to mitigate them.

Few universities around the country have risk management and insurance majors or concentrations in their business school curriculum. Most are large state universities. The business world, eager for some intelligence in risk understanding, underwriting, evaluation and mitigation, snatch these graduates fast.

However, these grads too often do not become the ballyhooed gurus of Wall Street – the ones with the fawning profiles and kingly compensation — and that is reflected in academia, where no risk management education is a mainstay.

Accreditation bodies demand aspects of ethics and global studies in university courses. Both are important. But it is risk management that is our best bet of averting another calamity in the fast-moving, incredibly complex financial system of our day and age. It should join them as a required component of any business education.

We must overcome a deep misunderstanding of risk management that is frightening in its persistence. ■

Dr. Etti G. Baranoff is an associate professor of insurance and finance at Virginia Commonwealth University in Richmond, VA and the author of "Risk Management and Insurance." Prior to her academic career, Dr. Baranoff spent 12 years as an insurance regulator with the Texas Insurance Department.

Insurance lessons from the mortgage meltdown

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"Affordable" Insurance

For insurers, selling coverage to a property owner at a price below the inherent risk always ends badly. The Republicans don't want insurers to slow economic development along the coast by charging a prohibitively high price for insurance. The Democrats don't want people complaining that they're choosing between food and homeowners insurance. And so all politicians argue that insurance must be "affordable," as if that should be any more of a factor in setting an insurance price than it should be for making a home loan.

> "*We submit that it is infinitely easier to calculate mortgage default risk than insurance catastrophe risk.*"

If someone doesn't make enough money to own a home, they should rent. You may not like the social implications, but if you ignore the natural laws of money, eventually this newly minted homeowner is likely to lose that home and the economic impact will be nasty. Short of a direct government subsidy, you can't live long in a house you can't pay for.

Ditto homeowners insurance. If the marketplace determines that it costs $12,000 a year to insure a modest coastal bungalow, it is folly to charge half that price. Eventually, the big storm will come and the insurer will not be able to pay claims, and the homeowner will lose their house anyway.

So . . . the current mortgage crisis is a perfect tool for insurers defending themselves against complaints that their products are not "affordable." The real numbers did not lie in the mortgage market, and denial of this truth has led to economic ruin. The real numbers also won't lie in catastrophe risk, and woe to all who deny this truth.

A tiny digression here: We submit that it is infinitely easier to calculate mortgage default risk than insurance catastrophe risk. The biggest unknown variable for mortgages is general economic health. You can plan all you want, but if unemployment surges to 12%, people are going to default on their loans. Suppose this drives your defaults to 6%, a very big number. Still, it won't kill a prudent bank. And we should note that the weak economy is not what has laid the mortgage market low. The foolishness of the mortgage market is what is killing the economy, not the other way around.

But in homeowners insurance, if you get the price wrong, you get it wrong for virtually every risk. If an insurance company broadly underprices risk, the day after the big catastrophe that company will be gone. The variables that one needs to master in order to come up with an accurate catastrophe insurance price are so vast as to be beyond the reach of today's skills. Insurers try their best, and sophisticated computer models have improved pricing dramatically over two decades ago, but in truth pricing is still very much a guessing game.

And yet, for all the complexity of insurance, and the alleged genius of bankers and investment bankers, the insurance industry has succeeded in weathering numerous giant catastrophes in the past 15 years with not a single insolvency of note, while the banking industry has gone into collapses so spectacular it has taken billions of taxpayer funds to bail them out.

Maybe the "smartest guys in the room" are not found on Wall Street, but in Bloomington, Northbrook, Los Angeles, Columbus, Hartford, Boston and San Antonio, where the nation's biggest property insurers are found. Though the big quake in California or a big storm hitting Miami will bring the industry to its knees, we'd be willing to bet it would not be a face plant such as the one bankers have suffered.

So lesson #1: An "affordable" homeowners insurance policy is one that a homeowner can afford given their income and other expenses. An "affordable" policy is not a policy that is underpriced to make it affordable to someone without enough income to bear the full price.

Value of Federal Regulation

Let's move on to the next lesson: The value of federal regulation. In September, as the mortgage market moved into the serious stages of its death throes, a number of journalists and Wall Street types contacted us about our longstanding skepticism concerning the potential for federal regulation of property/casualty insurance. Given the perceived role deregulation played in the banking crisis, didn't we think this event could sound a death knell for state regulation of insurance?

We were surprised they bothered to ask. If anything, the current crisis only points out that federal regulation, which is how banks and investment banks are regulated, did nothing to protect the economy from this disaster. If anything, one could argue that the incestuous relationship of regulator and regulated on the federal level is even worse than the alleged revolving door between the insurance industry and state regulators.

> ***"Maybe the 'smartest guys in the room' are not found on Wall Street, but in Bloomington, Northbrook, Los Angeles, Columbus, Hartford, Boston and San Antonio."***

Don't get us wrong. When it comes to solvency issues, it would appear true that a federal regulator would be better equipped than most state regulators in tracking catastrophe risk, global risk, the stability of reinsurance backing, etc.

But while this makes sense on paper, we see little evidence that it is true in practice. We refer back to how well property insurers, in particular, have fared in the face of their biggest risks — catastrophes. Those rubes at state insurance departments must be pretty lucky, we suppose, to have escaped the embarrassment of major insurer insolvencies. Or could it be that these allegedly overmatched state regulators know what they're doing?

How about more regulation? To be sure, it appears that bankers were allowed to do things structurally that were a bad idea. But we submit that the real failures here have more to do with regulators than regulations. That is, current banking regulators are charged with making sure bankers do not lend irresponsibly. Bankers should not be allowed to lend money to people without a chance of paying the money back. Loans made with no income documentation are little different from homeowners insurance policies written on a house about which nothing is known.

Even worse, loans were made for 100% of the supposed property value. The homeowner had no real stake in the property. That's like a homeowners insurance policy without a deductible. When tough times come, the homeowner needs a reason to share common cause with the lender or insurer. Mortgages made to a homeowner who makes no down payment are folly.

Here's a foolishness that insurers shared with mortgage lenders: a failure to accurately assess the property. For the past decade, home appraisals have been closely tied to the purchase price. Though some may disagree, we think bankers and appraisers have worked hand in hand to ensure that deals were done. If an appraiser killed a deal with too low an appraisal, the mortgage originator would stop sending the appraiser business.

Remember, the originator had no default risk, and therefore no concern for the appraisal other than the legal need to get a number that would allow the deal to get done.

Insurers have been making the exact same mistake for decades. Agents, who have little to no stake in the underwriting risk, were responsible for coming up with the insured replacement cost of a property. Since total losses were rare, the agents' risk of being challenged for their work was low.

And the agents' interest was not in underwriting, but rather in getting the deal done at a price that would satisfy the consumer. This led to gross undervaluation of home replacement costs, something the industry has only addressed in recent years. Though improved, insurers remain woefully bad at calculating the true risk of the properties they insure.

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The Government's Role

In looking at catastrophe risk, most people reach the conclusion that government must play a role. While we agree, the mortgage crisis proves there are terrible risks when the government gets involved. And though governmental involvement has yet to become a catastrophic problem for the property insurance markets, most signs point to trouble.

Let's start with the lessons from banking. In the 1970s, the government noted that savings and loans (S&Ls) were struggling, as rising interest rates meant banks had to pay 10% or so for deposits. This was OK for many lenders, since they were making loans at 15% and profiting on the spread. But savings and loans had long-term mortgages on the books at 5% interest. This mismatch, if it persisted, would put them out of business. Big depositors knew this, so they avoided S&Ls.

> *When tough times come, the homeowner needs a reason to share common cause with the lender or insurer.*

To ensure that S&Ls could attract deposits, the federal government expanded deposit insurance. They also either encouraged, or looked the other way, as S&Ls gambled with deposits, betting on the direction of interest rates, buying up and/or developing high-risk real estate assets.

The problem: depositors were freed from any responsibility to make sure they were putting their money in a safe bank. If an S&L was offering an irresponsible interest rate on deposits, who cared? The federal government would make good. Similarly, if the federal government was willing to look the other way, bank management was free to try anything to overcome the structural shortcomings of the traditional S&L balance sheet. The net result? A catastrophic failure of an entire industry. When the federal government takes away risk, it takes away responsibility.

Similarly, Fannie Mae and Freddie Mac were quasi-governmental entities that were the grease that kept the secondary mortgage market moving. There is debate over the formal guarantees that Fannie and Freddie made on the securities they fashioned, but there is little debate that most market participants believed that the full faith and credit of the federal government stood behind the market. Thus, even if the numbers looked a bit sketchy, there was no serious concern about asset quality. The market assumed they were in a low-risk environment.

Such implicit guarantees do indeed foster confidence in the market, improving liquidity and efficiency. But guarantees also led to reckless behavior. For example, depositors don't concern themselves with the quality of their bank, since all deposits up to $100,000 are created equal. Thus, **Wells Fargo Bank** (owned in part by **Warren Buffett**) enjoyed no competitive advantage for its wise avoidance of excessive real estate lending. In fact, it was at a substantial disadvantage to **Washington Mutual**, which was irresponsible in its behavior, and because the risks taken could offer higher deposit rates.

A sad irony of the most recent banking bailout is that Wells Fargo should now be reaping the reward of its intelligence, but instead the shareholders and depositors of irresponsible banks get to keep much of their gains, and Wells Fargo is not fully rewarded with additional market share as it now competes with government-backed competitors.

What does this tell us of government-backed reinsurance programs? It tells us that they keep markets open and moving smoothly. For example, you can more easily and cheaply buy homeowners insurance in Florida thanks to state intervention in the market.

But it also tells us that the explicit state guarantee leads to irresponsible behavior. For example, the **Florida Hurricane Catastrophe Fund** (whose staff seems to be working as diligently as possible) was pushed by politicians to make enormous reinsurance guarantees. Those guarantees now stand at $28 billion, but a recent staff examination finds that if a storm hit the state tomorrow, the Fund would only be able to come up with $13 billion. Why? Something about no one taking a possible credit crunch into account when making promises. This potential financial disaster makes barely a ripple in the local newspapers, but if a storm hit, this failure would be catastrophic for Florida residents.

The same can be said of Florida's state-backed **Citizens Property Insurance Corp.** This entity is the black hole of homeowners insurance. Policies are sucked out of well-capitalized insurers into Citizens, and they only escape when they find a less-capitalized home. As with the Hurricane Fund, Citizens relies on borrowing and assessments on Florida residents.

The borrowing power, which may never have been as great as projected, is certainly diminished today. And assessments against unemployed consumers are hard to collect.

Is the solution to do nothing? No, catastrophe risk requires government involvement of some sort because its complexity is currently beyond the reach of the insurers' skills. But beware the quasi-government solution. Few people want to see all catastrophe risk find its way to a total government solution.

The Bottom Line

The current financial crisis provides clear lessons for property/casualty insurance markets, particularly catastrophe risk, namely:

- Do not separate price from risk. There is no such thing as "affordable" insurance. There is a risk, and there is a price for the risk.
- Do not separate risk from reward. If someone does not have a stake in the quality of the underwriting, be it mortgages or insurance policies, do not give them any control over decision-making. This means agents should have as little involvement as possible in the underwriting and pricing of catastrophe risk.
- Align risk and decision-making. It is more about the quality of regulation than the structure. A federal regulator who has resources and power, but fails to use them, is actually more dangerous to a market than an overmatched state regulator who cares.
- Involve the government at great peril. Not that the government can't help. There are success stories, if you consider the Federal Flood Insurance Program a success, and if you feel confident that the as yet untested **California Earthquake Authority** is doing things right.

Neither insurers nor regulators can stop the storms, the earthquakes, the dog bites, the leaky pipes from happening.

But when it comes to market structure, don't stand idly by as mistakes already made by the banking industry are foisted upon you. Resist! ■

Brian Sullivan is the California-based editor of Property Insurance Report (PIR) and Auto Insurance Report (AIR). This article is drawn from a piece in the 11/10/08 issue of PIR. Sample copies and subscription information are available through www.riskinformation.com.

There is a place for *YOU* on IRES Board of Directors

This summer, six positions come open on the IRES Board of Directors. IRES needs YOU!

Elections will be held in August, during the 2009 Career Development Seminar in Baltimore. There are also one-year positions on the Board that the Board may fill during the Tuesday Board meeting.

If you are interested in getting involved, please send an e-mail to Larry Hawkins, Chair of the Elections Subcommittee at: **lhawkins@ldi.state.la.us**.

Request an official nomination form. Or contact the IRES Office: ireshq@swbell.net. or (913) 768-4700.

"Going Green" Makes Good Environmental and Business Sense

by Steve Bushnell

"With the launch of its green buildings insurance coverages, Fireman's Fund is helping to power the green buildings movement in California and beyond."
— Evan Mills, Ph.D.
Staff Scientist, Environmental Energy Technologies Division, Lawrence Berkeley National Laboratory

Fireman's Fund Insurance Company has been a vocal advocate for green buildings since 2006. During that time, we have addressed over 75 groups delivering a clear and simple message: *Green building makes economic, environmental and risk management sense*. Here are three solid reasons to support the green movement:

- Green buildings are better risks than traditional buildings, making them attractive markets for insurance carriers.
- They emit fewer greenhouse gases, are typically better maintained and engineered, and are more economical to operate.
- The green market segment is growing dramatically, providing solid business opportunities for companies positioned to serve its needs.

By providing the first green insurance products for commercial real estate, Fireman's Fund differentiated itself as a thought leader in the insurance industry.

In October 2006, we launched three products specifically designed to protect both the financial and environmental investments of owners and managers of green buildings. Since then our Green Gard℠ insurance program has broadened to include coverage for manufacturers and commercial fleets as well.

These innovative insurance policies are aimed at customers that have built green from the ground up, have made green renovations to existing buildings, or want to rebuild green after a loss. Fireman's Fund worked closely with the U.S. Green Building Council to ensure that its coverage aligned with the industry's major green certification processes. As part of the product, Fireman's Fund pays for the green certification application process for a customer's building.

The Green-Gard Program

The Green-Gard green building coverage program includes:

√ **Certified green building coverage:** Restores a customer's property to its original, green-certified condition, including the cost to hire a Leadership in Energy and Environmental Design (LEED)-accredited professional to oversee repairs. In situations where the insured has surplus energy that it generates and sells, Fireman's Fund will reimburse the customer for loss of income if the insured is unable to sell power due to loss or damage to alternative power generating equipment.

√ **Upgrade coverage:** Gives the owner of a nongreen damaged building the option to rebuild green using materials such as nontoxic, low-odor paints and carpeting, Energy Star-rated electrical equipment, and interior lighting.

√ **Commissioning coverage:** Covers the costs to hire a commissioning engineer to ensure that a customer's building systems (HVAC, electric, and plumbing) operate at peak performance, and to test and balance these systems for peak energy efficiency.

√ **Sustainable building practices assessment:** Our risk services group will offer consultation services to our customers aimed at no- and low-cost green building business solutions including energy and water conservation, indoor environmental quality, materials and resources, and building site maintenance. The assessment provides key benefits for sustainable building practice and implementation strategies.

Success to Date

- Green insurance has not only been successful in the marketplace, it has also helped "authenticate" the importance of green building in the real estate and commercial building industries.
- Our customers range from real estate developers responsible for urban revitalization projects to

multi-family property owners to owners of large, luxury apartment buildings.

- The editors at Builders Magazine rated Green-Gard building coverage in their Top 100 Products list.

- Energy Star Partner, recognition by the Environmental Defense Fund and the California Governor's Energy and Environmental Leadership Award are a few of the honors received to date.

Customer Resource Center

Our customers find more green information through the Fireman's Fund iCustomer Series Green Resource Center, a free, online portal with industry-specific information, risk management tips, and links to vendors of green products and services at preferred prices. This resource is always being updated with articles, tools, and links to help our insureds understand the Green building movement and its many benefits.

Green Homeowners' Insurance

In addition to the commercial line of green products, Fireman's Fund launched "green" homeowners' insurance in June 2008. Following a covered loss, Fireman's Fund will rebuild our customer's home to green standards. These include:

- Use of Forest Stewardship Certified wood for millwork, ceilings, siding and framing;
- Energy Star listed appliances, including clothes washers and dryers, dishwashers, refrigerators and freezers;
- Energy Star listed home envelope, including home sealing (insulation and air sealing), roof products, windows, doors and skylights;
- Energy Star listed heating and cooling systems, including air-source heat pumps, boilers, central air conditioning, central fans, dehumidifiers, furnaces, geothermal heat pumps, home sealing (insulation), programmable thermostats, room air conditioners, and ventilating fans;
- Low volatile organic compounds (VOC) paints, adhesives and sealants;
- Energy Star listed lighting fixtures, light bulbs and ceiling fans;
- Low-flow plumbing fixtures;
- Carpeting that has passed the Carpet and Rug Institute's standards for low emissions; and
- Debris from the loss will be recycled.

LEED-certified homes receive a 5% premium discount.

Fireman's Fund is part of the Allianz Group, which has made a global commitment to climate change. The Group's response to climate change is centered around the international strategy on sustainable development. This strategy begins in-house, with targets for reducing our global carbon emissions 20% by 2012 and managing climate risks across our businesses.

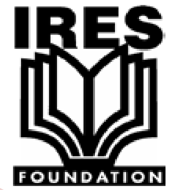
Allianz is also chair of the United Nations Environment Program (UNEP) – Financial Initiative Climate Change and has partnered with the Worldwide Fund (WWF) to evaluate and build awareness of climate change risks and opportunities among our industry and customers.

Our innovations are part of a broader international effort. Allianz recently formed an Insurance Climate Change Center of Competence that regularly convenes many of our largest global insurers to transfer knowledge and share best practices towards innovative climate solutions. Similarly, Allianz established an independent business unit, "Allianz Climate Solutions," to integrate and customize such innovations across our insurance, asset management and banking lines of business.

Today, we offer green innovations as climate solutions. Globally, we are focused on the transition from awareness to action and are scaling our efforts to innovate insurance products that help customers reduce and adapt to the climate risks they face, while helping reduce the risks to society and our industry. ■

Steve Bushnell is product director for the Fireman's Fund Insurance Company.

Savannah 2009



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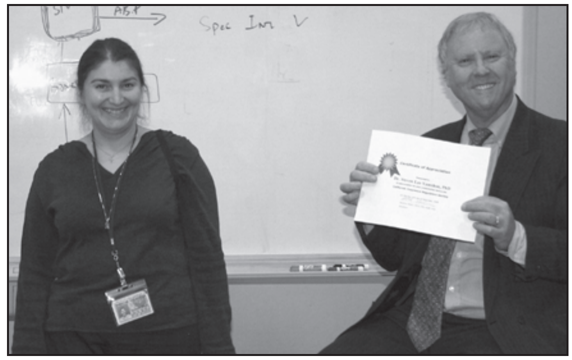
IRES Chapter News

VIRGINIA — Twenty-one members of the Virginia Chapter attended the VA Chapter meeting last year that focused on the St. Louis Career Development Seminar (CDS). **Katie Johnson**, **Weldon Hazlewood**, **Bryan Wachter**, and **Andrea Baytop** summarized the sessions for attendees. Congratulations also were extended to Bryan for receiving recognition at the CDS for achieving his Accredited Insurance Examiner (AIE) designation.
— *Andrea Baytop; andrea.baytop@scc.virginina.gov*

CALIFORNIA — Welcome to our new Chapter co-chair **Nicoleta Smith**, CIE, CPCU, ALMI, ACS, Supervising Insurance Compliance Officer. Nicoleta has been instrumental in organizing seminars and Chapter meetings. On December 11, the Chapter sponsored a lively discussion on the current financial markets presented by **Dr. Steven Lee Yamshon, PhD**. About 50 IRES members and nonmembers attended. The Chapter plans to develop more training sessions in the near future.
— *Polly Chan; ChanP@insurance.ca.gov*



Nicoleta Smith presents Dr. Yamshon with a certificate of appreciation.

“ Quote of the Month ”

We are extremely disappointed by today's SEC decision. The states have a demonstrated record of consumer protection, and we do not believe this rule is in the best interest of insurance consumers.

— Susan Voss, NAIC Vice President and Iowa Insurance Commissioner, commenting on the adoption by the U.S. Securities and Exchange Commission (SEC) of Rule 151A that classifies equity-indexed annuities as securities, subject to regulation by the SEC. Equity-indexed annuities are currently regulated by state insurance departments. With the adoption of this rule, the SEC could begin regulating these products in 2011.

Regulatory Roundup

by
Stroock & Stroock & Lavan LLP

New York — Insurance Department issues circular letter advising carriers on treating all married couples equally

On November 21, the New York Insurance Department issued Circular Letter No. 27 (2008), advising that same-sex spouses to marriages legally performed outside of New York must be treated as spouses for purposes of the New York Insurance Law, including all provisions governing health insurance. Circular Letter No. 27 is based on an opinion issued by the Department's Office of General Counsel and cites the Appellate Division's February 1, 2008 decision in *Martinez v. Monroe Community College*, 50 A.D.3d 189, 850 N.Y.S.2d 740 (4th Dep't), *lv. to appeal denied*, 10 N.Y.3d 856 (2008), in which the court held that plaintiff's marriage to her same-sex partner was entitled to recognition in New York State as a matter of comity.

The case arose after plaintiff's employer denied her application to obtain health care benefits for her same-sex spouse, whom she had married in Canada, even though the employer provided such benefits to the opposite-sex spouses of its employees. Given the controlling authority of *Martinez* and several opinions from lower New York courts consistent with that holding, the Department declared that all carriers are expected to provide legally married couples with the same rights and benefits, regardless of the sex of the spouses. Further, the Circular Letter states that an insurer's refusal to extend health insurance or other insurance coverage on an equal basis to same-sex and opposite-sex spouses may constitute an unfair act or practice under Insurance Law §§ 2402 and 2403, and/or unfair discrimination under Insurance Law Article 23 and § 4224. The Circular Letter also mandates that, to the extent necessary, carriers must file new policy forms or policy form amendments with the Department to ensure compliance with this directive. To view Circular Letter No. 27, visit **www.ins.state.ny.us/circltr/2008/cl08_27.pdf**.

Oklahoma – Bulletin mandates use of System for Electronic Rate and Form Filings ("SERFF")

The Oklahoma Insurance Department issued Bulletin No. LH 2008-02 and PC 2008-05, advising that, effective July 14, 2009, the Rate and Form Compliance Division of the Oklahoma Insurance Department will no longer accept paper filings, applicable to all lines of insurance and for all rate, rule and form filings. After July 14, 2009, unless specifically exempted by Order of the Commissioner, all filings must be filed via SERFF or will be rejected.

This mandate is not limited to licensed insurers but also includes all filings submitted by service warranty companies, utilization review companies, viatical settlement providers and brokers, discount medical plan programs, pre-need funeral plans, health maintenance organizations, and pre-paid dental plans. The Insurance Department also anticipates the mandatory use of Electronic Funds Transfer (EFT) for payment of filing fees. To view Bulletin No. LH 2008-02 and PC 2008-05, visit the Oklahoma Insurance Department's Web site at **www.ok.gov/oid**.

New York – Insurance Department postpones plans to regulate certain credit default swap contracts

On November 20, the New York Insurance Department issued a Supplement to Circular Letter No. 19 (2008), delaying indefinitely its application of New York Insurance Law to credit default swaps ("CDS"), as

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

originally described in Circular Letter No. 19, since proposed federal legislation to regulate CDS contracts has been introduced. The Supplement notes that, on Nov. 14, 2008, the President's Working Group on Financial Markets announced a series of initiatives to strengthen oversight and transparency and to create a centralized market infrastructure for the over-the-counter derivatives market, including CDSs. The initiatives include the development of CDS central counterparties, some of which are expected to begin operations before the end of 2008. To view Supplement No. 1 to Circular Letter No. 19, visit **www.ins.state.ny.us/circltr/2008/cl08_19s1.htm**. To view the President's Working Group announcement, visit **www.ustreas.gov/press/releases/hp1272.htm**.

Florida – Office of Insurance Regulation issues proposed rule on unfair discrimination in motor vehicle rates

The Florida Office of Insurance Regulation ("OIR") has issued a proposed rule that would prohibit the imposition of additional premium on an existing or new insured based upon non-fault accidents. The proposed rule, which amends OIR Rule 69O-175.008 ("Unfair Discrimination in Private Passenger Motor Vehicle Insurance Rates Based on History of Accidents"), would prohibit insurers from using any motor vehicle accident which may have occurred at any time in the past as the sole basis for imposing or requesting additional premium or for refusing to renew any of motor vehicle liability, personal injury protection, medical payment, or collision insurance unless the insurer in good faith determines that the insured was "substantially" at fault in the accident.

A public hearing on the proposed rule is scheduled for January 13, 2009. To view the proposed revisions to OIR Rule 69O-175.008, visit the OIR's website at **www.floir.com**.

New Jersey – Legislature considers proposal prohibiting auto insurance rating based on education or occupation

On September 22, Assembly Bill No. 3202, a measure that would prohibit automobile insurers from assigning an insured to a rating tier based upon an insured's: (1) educational level; or (2) employment, trade, business, occupation or profession, was introduced in the New Jersey Assembly and referred to the Financial Institutions and Insurance Committee. The Bill would also prohibit automobile insurers from requiring, as to any application or selection of coverage, any information from an insured or applicant as to these factors. The Bill would take effect 90 days following enactment. To view, Assembly Bill No. 3202, visit the New Jersey Legislature's website at **www.njleg.state.nj.us**.

CE News

The 2009 IRES membership dues were mailed out in December. Dues need to be paid by February 15. Unpaid memberships will result in lapsed IRES designations.

When completing the back of your dues invoice, review it carefully to make sure your profile information is accurate, especially the e-mail address. It is vital that we have accurate contact information for all members.

The e-mail address is especially important because without it you may miss important notices regarding IRES educational programs and pending deadlines. In addition, having an e-mail address on file is required to access the "members only" area of the IRES Web site.

N · I · C · E

National IRES Continuing Education

The mandatory continuing education program for AIE and CIE designees

Casual Observations

A market solution to a market failure?

Although health care costs have been squeezing Americans for years, the pressure has intensified during the current recession. Some employers are cutting their health care costs by raising deductibles, co-pays and employee contributions, while others have simply dropped the benefit, leaving employees in the lurch.

Those lucky enough to have health insurance through their employers worry that it won't be there a year or two from now. And those living in one of the many states that permit health insurers to exclude individuals with pre-existing conditions have even more to fret about.

Would such worries be lessened if consumers knew they could buy health insurance coverage at some future time even if they became uninsurable? A subsidiary of a major U.S. health insurer believes they would.

Last month, the company introduced an option for healthy insured individuals to lock in a health insurance plan in case they lose their current coverage due to job loss, early retirement, a shift to self-employment, etc.

The new option plan would be open only to healthy individuals provided they pass a one-time medical examination prior to purchase. Once accepted, they would never find themselves shut out from the health insurance marketplace.

But unlike those stock options routinely granted to corporate executives, this option comes at a price. It will cost an individual 20% of the current cost of the plan he or she selects.

So, let's say you are 40 years old, healthy and insured through your employer's health plan. Let's further assume that your share of the costs for that coverage is not insignificant, and you're concerned that you may someday lose your insurance and perhaps be too sick for individual coverage.

You are therefore interested in buying this new option and have found a suitable high-deductible plan offered by the insurer. The insurer's plan currently costs $250 a month. Thus, your cost to reserve a future right to participate in the plan would be $50.

But that $50 will increase as the cost of your chosen plan rises and there's no limit to how much the policy you selected would ultimately cost should you decide to exercise your option. In fact, you could be paying $50 a month for an option to buy an unaffordable product.

Although these options seem loaded with pitfalls, we're not blaming the company that sells them. They're just looking to fill a perceived gap in the marketplace. The real blame rests with the patchwork-quilt system of health care financing in this country. If lawmakers want to see how truly flawed our health care financing system has become, they need look no further than this product.

In a sane health insurance market, no consumer should be buying protection to avoid being excluded. Most consumers can't figure out their own health insurance policies. We can't imagine their trying to determine which policy would make sense five or ten years down the road.

Several states currently allow individuals with pre-existing conditions to purchase health insurance in the private market provided they (1) had previous coverage within the past 60 days or (2) serve a 9-to-12 month waiting period for coverage of treatments relating to their pre-existing conditions. In these states, insureds are not being shut out, thus these options would have no value.

Yes, states that have not embraced open-enrollment and community-rating approaches to health care insurance can boast lower premiums for younger individuals, but such premiums offer illusory savings. We all grow older and before too long (assuming the current system doesn't change) many of these younger, healthy people will learn that — in addition to high premiums, co-pays, and deductibles — they now have to contend with options to guarantee future coverage.

Perhaps Peter V. Lee, executive director of national health policy for the Pacific Business Group on Health, described this option plan best: "It's an attempt to have a market solution to a market failure."

— W.C.

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Seminar Fees

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- ☐ Spouse/guest meal fee................... $80

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  PAID Spouse/Guest name
- ☐ **If registering after July 9 add $40**

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No registration is guaranteed until payment is received by IRES. A $25 cancellation fee will be assessed if canceling for any reason.

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

Hotel Rooms: You must book your hotel room directly with the Marriott Waterfront Hotel. Call group reservations at 800-228-9290 or hotel direct at 410-385-3000. The IRES convention rate is available until July 9, 2009 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. To book your hotel room online go to the IRES Web page http://www.go-ires.org/events/future.cfm

$179.00 Regulator hotel rate

$199.00 Non-Regulator hotel rate

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CANCELLATIONS AND REFUNDS

Your registration fee minus a $25 cancellation fee can be refunded if we receive written notice before July 9, 2009. 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, 2009.

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

BULLETIN BOARD

√ Now is the time to think about running for the IRES Board of Directors. If you're a working regulator and would like to advance your professionalism and your career, send an e-mail to **Larry Hawkins**, Chair of the Elections Subcommittee at: lhawkins@ldi.state.la.us.

√ Seats are still available for the MCM program in Savannah, GA, May 6 - 8, 2009, immediately following the IRES Foundation's National Insurance School on Market Regulation. For more information, visit **www.go-ires.org** or e-mail **Jo LeDuc** at jo.leduc@wisconsin.gov.

√ **Mary Darby**, the Delaware Insurance Department's Director of Consumer Services, has accepted a position as Director of Constituent Relations in the new administration of Delaware Governor Jack Markell, who assumes office this month. As a member of the Publications Committee, Mary has contributed articles and provided invaluable editorial expertise to *The Regulator*. We thank her and wish her continued success in this exciting new endeavor.

√ If you're going to the IRES CDS in Baltimore, plan to join us for baseball in Birdland. The Orioles will play the Oakland A's at beautiful Camden Yards on Monday, Aug. 10, at 7:05 pm. Tickets are approx. $25. Contact **Marty Hazen** at mjhazen@ksinsurance.org or **Rich Nebb** at RNebb@ins.state.ny.us.

In the next REGULATOR:

Solvency implications of annuities

Bulletin Board items must be no more than 75 words, and must be accompanied by the sender's name, e-mail address and phone contact information. Submit plain, unformatted text (no special font stylings, underlined hyperlinks or special margins). Email to Wayne Cotter at: quepasa1@optonline.net.

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"Where do the states fit in?"

Story, page 1