The Regulator®
INSURANCE REGULATORY EXAMINERS SOCIETY

Some Life Insurers Getting Reserve Relief Through 'Backdoor' Efforts

by Steve Tuckey,
Special to *The Regulator*

State insurance regulators have come under fire for allegedly granting backdoor capital and reserve requirement relief to life insurance companies struggling with deteriorating conditions that may soon force them to make difficult choices to maintain solvency standards.

In the weeks following the Jan 29 National Association of Insurance Commissioners Executive Committee's stunning 16-1 rejection of previously approved fast-track solvency relief measures, regulators' attempts to permit case-by-case exceptions have raised concerns from both consumer groups and others that such measures are being granted without a full airing to expose the potential dangers to consumers.

"What they did not want to do publicly, they are trying to do behind closed doors," said one regulator quoted anonymously in *The Washington Post*. "I think this jeopardizes policyholder security."

The regulator was referring to a closed conference call on Feb. 6 in which commissioners discussed how to implement so-called "permitted practices" to struggling companies that would permit them to implement those solvency relief measures previously rejected by the Executive Committee. Regulators have said they have always had the flexibility to grant such relief, but with requests pouring in from companies across the nation, the issue becomes how rare such exceptions are and under what conditions they are granted.

In an e-mail exchange with Robert Hunter, insurance director for the Consumer Federation of America, NAIC vice president and Iowa commissioner Susan Voss wrote "I certainly never agreed case-by-case should be for all or even more than a very few insurers."

She was reacting to concern expressed by Hunter that such relief measures would amount to regulators "anointing winners and losers" in doling out such relief measures "like lollipops at a barbershop."

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Variable Annuities Coming Back to Bite Life Insurers

The current financial turmoil seems to have bolstered variable annuities' (VA) status as the top whipping boy in the financial products realm as questions about reserves and regulatory turf wars continue unabated.

Product sales sank in 2008 as concerns about falling stock prices and rising fees led investors to shy away from the product. According to one trade group, LIMRA International, sales fell from $48 billion in the fourth quarter of 2007 to $38 billion in the third quarter of 2008. The Kehrer-Jackson Annual Monthly Bank Annuity Sales Survey reported that $1.3 billion in variable annuities were sold in the banking channel in September 2008 compared to $2.3 billion in October 2007.

As the product took off in the boom years of the last century,

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From the President

Spring is in the Air

Well, it's March again and IRES just passed the half-way mark of its Committee year. With spring in the air (or not, depending on where you are), it seems like a good time to provide an update on the many things the committees have accomplished so far this year and to offer some insight into the items on which the committees continue to work.

The Accreditation & Ethics Committee, chaired by **Anne Marie Narcini**, has been especially busy. So far, they have updated the NICE manual to include the many changes made last year and added several course options to the AIE curriculum. The Committee continues to work on several important issues, such as reviewing the treatment of continuing education (CE) credit for online courses, investigating the possibility of allowing CE credit for members who help IRES outside of regulator Committee work, and exploring the feasibility of creating a professional designation program for regulators who work for consumer services divisions of insurance departments.

Under the direction of **Gary Kimball**, the Budget & Finance Committee completed its most important task of the year, assembling the 2009 IRES budget. I am happy to report that the budget has been adopted by the IRES Board and can be found in the Members Area of the IRES Web site. The Committee has now turned its attention to arranging for an independent review of the IRES financials.

The Education Committee, chaired by **Dennis Shoop**, has made significant progress on the

2009 Annual Career Development Seminar (CDS). Having completed the planning of the workshops and general sessions, the Committee will now put the finishing touches on the CDS including finding top-notch speakers for all the wonderful sessions they have planned. Everything you need to know about the CDS can be found on the IRES Web site.

The Meetings & Elections Committee, chaired by **Tom Ballard**, has selected Minneapolis, MN as the location for the 2011 CDS. Beginning in 2010, the NAIC will meet three, rather than four, times a year. Its summer meeting is scheduled for early August 2010 and would create a conflict with the 2010 CDS dates. As a result, the Committee has approved changing the dates for the 2010 CDS to avoid the conflict.

The Committee is currently seeking individuals interested in running for the Board and selecting target cities for the 2012 CDS.

The Membership & Benefits Committee has also been very active again this year. Chaired by **Leslie Krier**, the Committee has a lot in the works, including finalizing our outing to Camden Yards, home of the Baltimore Orioles, during the 2009 CDS; gearing up to sell IRES shirts; finalizing a handbook for State Chairs; and planning the publication and sale of an IRES cookbook. The Committee is also seeking nominations for the **Al Greer Award**. If you know of a qualified deserving regulator, please consider nominating him or her (see details, p. 17).

Led by **Polly Chan**, the Publications Committee continues to tackle the daunting task of putting together each issue of *The Regulator*. In addition, this year the Committee has been studying the feasibility of selling advertising space in *The Regulator* and refining the current procedures regarding the distribution of information to the membership via e-mail blasts.

Lastly, the Executive Committee and Board have been working on crafting a long-range vision for IRES. They have also been reviewing the need to develop a succession plan and the possibility of implementing new procedures in response to a change in the IRS tax form filed each year by IRES.

I want to extend my sincere thanks and gratitude to the Board, Committee Chairs and all of the Committee members, too numerous to name. It is the countless hours of time that these volunteers have graciously donated that have helped make IRES the strong and vibrant organization that it is.

As always, if you have any questions, please contact me at jo.leduc@wisconsin.gov or (608) 267-9708.

Jo A. LeDuc, CIE, MCM
IRES President

Life Insurers Getting Reserve Relief

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"Nobody said dealing with this financial crisis was going to be easy." American Council of Life Insurers (ACLI) chairman Pat Baird did not find too much agreement with his group's contention that the life insurance industry needs immediate relief from certain minimum reserve and capital requirements at an NAIC working group hearing earlier this year. But few disputed his final words quoted above as he left the hearing.

Late last year, the ACLI made a number of proposals to alter certain reserve requirements in the light of the virtually unprecedented squeeze faced by the American economy as the one-two combination of the credit crunch and recession continues to take its fearsome toll. Numerous changes have already been under review and some for several years. But the request of the life insurers to speed up enactment in time for the 2008 financial statements raised general concerns in many quarters that now was not the time to loosen regulatory standards.

The life insurers lost Round 1 when the regulators decided against putting the changes on any fast track. But the battle is far from over as a number of complex technical proposals must now face scrutiny from regulators, lawmakers and ultimately a general public wondering how things could have deteriorated so swiftly.

Redundant Reserves

Commissioner Voss said many of the ACLI proposals have been on the table for more than four years and can fall under the general category of a switch to Principles Based Reserving (PBR) in which carriers don't follow strict so-called "bright lines" but rather solvency goals. "There are some life products out there if you look just at the strict formula, they do have redundant reserves. And so we have been trying to come up with some kind of system that does not require those redundant reserves."

The ACLI said the proposed changes would free up between $25 billion and $35 billion in capital, which represents about 7% of the total capital for 2007. "None of these changes could be considered to fix longstanding concerns with the reserve methodologies contained in the current regulations and actuarial guidelines, but they would have provided some reserve and capital relief, while maintaining prudent standards that are needed in the regulation of financial services companies," said ACLI spokesman Whit Cornman.

But getting actuaries and other financial experts within the industry to agree on just where the redundancies are proved a daunting task and one that apparently could not be accomplished in a few short years. "And so I think in the end when a lot of commissioners looked at it, and we are talking about retrospective changes, I am not sure a lot of us felt that at this time the optics made sense to do it retrospectively," Voss said. (**Editor's Note:** The term "optics," which has gained considerable traction during the current economic crisis, refers to the public perception of a decision rather than its substantive or economic merit. For example: Although the decision last year by auto executives to take corporate jets to Washington to testify before Congress may have, arguably, made some economic sense, the negative optics associated with the decision should have outweighed those considerations.)

Proposals falling in general under the PBR category include ones that allow for the expanded use of the 2001 Preferred Mortality Tables, which are currently only available for policies issued in 2007 or later. Another proposal would have expanded the use of less conservative reserving standards for universal life products with secondary guarantees for policies issued in 2005-06, while a third would have eliminated limits on the use of factors that lessen the impact of Regulation XXX, a.k.a. Triple X. The ACLI also sought to expand existing collateral availability as well as the use of deferred tax assets in calculating solvency.

Optics

At a time when our newly elected president is taking to the airwaves to denounce $18 billion in bonuses for the banking industry, and commentators are wondering how one can spend $1,400 on a wastepaper basket, regulators have become more attuned to optics. At the hearing, New York Supt. Eric Dinallo said he concluded that adopting the proposals could be seen as diluting existing protections and would send a message that the industry needs emergency relief, which he did not believe to be the case. His Pennsylvania counterpart, Joel Ario, made much the same case noting that none of the domestics in his state said such relief was needed now, only that it would be desirable.

Longtime NAIC observers expressed surprise at the Executive Committee's stunning 16-1 rejection of the ACLI's proposals as they came after weeks of consideration by the technical committee and a great deal of effort from member companies. "I have been around a long time and know how these things generally work, and believe me there must be a lot of angst at the ACLI," said one industry veteran.

Following the vote, ACLI chief executive officer Frank Keating issued a statement assuring the public that the life industry has adequate reserves to meet its obligations. But he noted that adoption of the proposals would have provided "the financial cushion and operational flexibility" to help life insurers weather the economic turmoil. He did not say what plans the group had in the aftermath of the defeat.

> ***President–elect of the National Conference of Insurance Legislators Robert Damron said the ACLI had 'more guts than a slaughterhouse' in making its proposals at this time.***

As those closest to the voters, state legislators were the first to raise alarm. Kentucky state lawmaker Robert Damron, the president–elect of the National Conference of Insurance Legislators (NCOIL) was quoted as saying the ACLI had "more guts than a slaughterhouse" in making its proposals at this time. The current president, James Seward of New York, did not put it quite so colorfully but made much the same point when he said that "the proposal's timing could not be worse in light of the present economic decline, as it leaves the appearance standards are being relaxed when the rest of the world is calling for more oversight." Seward also said that any such relaxation would make the case for more federal regulation "by sending a message that state insurance commissioners are not standing firm against strong-arming from industry, an industry that wants to boost consumer confidence by supplying questionable capital relief."

While public relations are important, life insurers have to operate in the real world, said Scott Harrison, executive director of the Affordable Life Insurance Alliance. And this world does not have the same capital market solutions to the problems posed by redundant reserves it once did. "The loss of that alternative means of providing liquidity means that companies are now forced to bear the full weight of those excessive reserves," Harrison said. "This has a direct impact on the ability of these companies to raise capital. This is all occurring at the same time companies are seeing the same impairment of the assets that have affected every individual and corporate investor in the country."

Baird said that letters of credit are generally not available and those that are will be increasingly costly as banks de-leverage their balance sheets. "In this time of unprecedented economic stress, an insurance company has only extremely limited options to manage capital and liquidity. To the extent options are available, most destroy economic value," he said. Baird also attempted some of his own "optics" managing in trying to counter the notion that conservative is always better in times of economic stress that exist now. "The problem that must be addressed is that ultra-conservative capital and reserve standards paint an inaccurate picture of the financial health of the industry at the very time that consumers are making important decisions. Unless these inaccuracies are addressed, consumers could well make poor financial choices," he said.

Ratings agencies are among those charged with separating the "optics" from the reality of the proposed changes. In a report issued Dec. 15, Standard & Poor's said while the changes would increase the amount of capital the companies report, "they would have only a limited effect on our view of capital adequacy." The report also downplayed the role of capitalization in any company's ratings, noting that "we tend to upgrade insurers based on improved competitive position or operating performance."

While many of the ACLI proposals aimed at eliminating purportedly redundant reserves would fall under the category of those that would be covered by a

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Life Insurers Getting Reserve Relief

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move to Principles Based Reserving measures, others dealt with issues that have been topics of controversy for more than a decade.

Deferred Tax Assets

The industry has long sought to be able to take greater capital advantage of those tax losses not realized in a given year. But it encountered resistance from regulators who believe such illiquid assets really don't add all that much to a company's solvency picture. Generally Accepted Accounting Principles take a much more liberal view of Deferred Tax Assets (DTA) than is allowed in statutory accounting. The ACLI claims that declines in equity and fixed income investment valuations have given rise to future tax benefits that cannot be accounted for in statutory accounting.

The ACLI had proposed allowing DTA calculations expanded from the current one year to five years from the balance sheet date in the amount of 25% of surplus rather than the current 10%. A 3-year, 15% compromise from Wisconsin Commissioner Sean Dilweg was approved by the Working Group but in the end was rejected by the Executive Committee. The commissioner said while limiting the ability of regulators to respond to financially troubled situations as a result of the increasing DTA allowances is a valid concern, "I also understand the industry's concern of showing financial statements that do not recognize the going concern nature of the business," he said.

Voss seemed to recognize the dilemma when just several days later she issued a "permitted practices" bulletin that allowed companies in her home state to follow the 3-year, 15% compromise guidelines that she had rejected as part of the NAIC's Executive Committee. It was that bulletin and subsequent closed, regulator-only calls that ignited the current furor. Voss stressed there were limits in the use of the expanded DTAs and companies had to file a "detailed description how the DTAs are expected to be realized within the next three years and the company's total adjusted capital and authorized control level risk-based capital without using the permitted practices."

She also asserted that the use of permitted practices was a way of ameliorating any particular stress that some companies were undergoing as a result of any solvency standards out of whack with current economic conditions without resorting to a wholesale relaxation on such a swift basis as proposed by the ACLI. She hoped that the regulators would soon develop some sort of protocol so that such permitted practices could be implemented on a more standard basis.

The commissioner nonetheless came under fire from Birny Birnbaum, executive director of the Center for Economic Justice, who said the actions weaken consumer protections "because insurers will now be able to count a greater share of illiquid assets as part of admitted assets and statutory capital and deferred tax assets cannot be connected to cash if needed immediately."

Meanwhile, all indications are that conditions are continuing to deteriorate for the life insurance industry while the difficulties of obtaining regulatory relief as exemplified by the Center for Economic Justice and NCOIL protests continue to mount. While most media reports focus on residential mortgages in the financial meltdown, the commercial sector has generated its share of concern recently. In fact, one of the ACLI's rejected proposals would have altered the Mortgage Experience Adjustment Factor, which the industry says creates too much volatility when life insurers' portfolios undergo some mortgage defaults.

Corporate Debt

But it is the corporate debt in insurers' portfolios that have raised more alarm recently. In a recent research note, New York-based Barclay's financial analyst Eric Berg said that corporate defaults are poised for a significant increase this year. "None of the life insurers we studied appear to be doing a particularly good job of picking bonds. Understandably, investors are concerned," Berg wrote. The note quotes industry figures that account for $1 trillion in corporate debt held by life insurers. Meanwhile, life insurers' stock continues to plummet with Prudential declining by about 69%, Aflac dipping 62% and MetLife falling by about half in the past 12 months.

With those kinds of numbers, life industry efforts to gain some regulatory relief are far from over. But somewhat unfortunately for the life insurers, they seem to be the relatively healthy group in the financial services sector, according to NAIC president and New Hampshire Commissioner Roger Sevigny, who attributed their relative good fortune to state regulation. "Simply put, the industry has not made a credible case why we need to make changes on an emergency basis, and why those changes should be limited to specific proposals made by the industry," he said.

So in a sense, the regulators said that since things are not so bad for life insurers, compared to other industries, granting the extraordinary emergency relief asked for would paint a picture of doom and gloom that does not exist. Voss said that the proposals rejected for fast-track approval will now face the NAIC's "open, transparent and deliberative process" in a swift and efficient manner.

But Dewey LeBoeuf attorney and longtime industry observer Allison Tam had her doubts. "It remains to be seen how the NAIC's labyrinthine committee structure will accomplish that," she said.

Steve Tuckey has written on insurance issues for more than ten years for national publications including Risk and Insurance, the National Underwriter and Business Insurance.

Variable Annuities Biting Life Insurers

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insurers added more benefits to lure buyers. Insurers today are in a sense trying to undo those actions by scaling them back and raising fees as the costs of hedging programs continue to rise and as the risks they are designed to protect against escalate.

Hartford has been among the biggest players in the VA arena, accounting for about 20% of the carrier's $3 billion in profit in 2007. The company's "Principal First" product promised withdrawals of up to 7% a year to recover principal, with an opportunity on the fifth anniversary of the contract to add investment gains to the guaranteed amount. The innovation forced other companies to develop even more attractive products with some adding versions that lock in investment gains annually, monthly and even daily.

> *"Variable annuity concerns have been seen as a strong factor in the Hartford's 83% decline in shareholder value over the past 12 months."*

Variable annuity concerns have been seen as a strong factor in the Hartford's 83% decline in shareholder value over the past 12 months. According to a report from *The Wall Street Journal*, Hartford's Chairman Ramani Ayer let analysts know late last year that "the game is going to change." According to the report, he had directed a team of senior level managers to take some of the risk out of the product and will make major modifications in the annuity lineup this year.

Milliman Inc. senior consultant Kenneth Mungan said he expects to see many such product overhauls this year as "the status quo is simply unsustainable." "Because of the significant change in capital market conditions," Mungan added, "the increase in stock market volatility and the decrease in interest rates, the cost of manufacturing retirement savings guarantees has increased dramatically so that has caused existing products . . . to suffer a dramatic decrease in profitability."

Regulatory Input

Meanwhile, regulators have gotten into the act with the approval last October by the National Association of Insurance Commissioners of Actuarial Guideline VA-CARVM that is said to rely less on reserving formulas and more on Principles Based Reserving (PBR), the buzzword for the past few years in regulatory circles.

Tom Campbell, a life actuary with the Hartford who led the effort by the American Academy of Actuaries to revise the rule, said the guideline requires a modeling of the book of business over a broad range of scenarios. "So the fact that the benefits are more in the money, they are going to be modeled reflecting the increase in the value of the guarantees, and they are also going to be modeled assuming there are additional downturns in the market," Campbell said, asserting that the approach will be valid in the current economic conditions.

The current guideline, for example, contains what has been termed a redundant use of a stand-alone asset adequacy analysis that covers only VA living benefit guarantees and associated revenue under the contract. "VA-CARVM, on the other hand, looks at the entire contract and risk that the company is taking under a broad range of market scenarios including additional drops over what we have seen over the past year," Campbell said. "It better aligns the measurement of the reserve with the measurement of the risk and the way the company is managing those risks."

The rule will take effect December 31, 2009.

Equity-indexed Annuities

Variable annuities have also been the target of suitability concerns over the years with issues centering on whether they are appropriate for plans that are already exempt from taxation. Late last year, the Securities and Exchange Commission claimed jurisdiction over equity-indexed annuities if, in the SEC's words, "the amounts payable by the insurer under the contract are more likely than not to exceed the amounts guaranteed under the contract."

The SEC Chairman at that time, Chris Cox, said that equity-indexed annuities pose a particular danger to seniors who may risk a substantial portion of their investment if they need their money for medical emergencies. "At the same time, their upside is typically limited to less than what they would have gained by directly buying the indexed securities," he said in a statement.

The industry immediately fought back by filing suit in the U.S. Court of Appeals in the District of Columbia seeking to invalidate the rule. Former North Dakota Insurance Commissioner Jim Poolman, representing a coalition of six companies involved in the suit, said "it is unfortunate that the SEC seeks to duplicate state efforts to regulate indexed products when at the same time it has come under heavy criticism to adequately meet its core mandate of overseeing the securities industry."

The National Association of Insurance Commissioners joined in the protest by also filing suit, along with the National Conference of Insurance Legislators (NCOIL), in the U.S. Court of Appeals in the District of Columbia. NAIC Vice President and Iowa Commissioner Susan Voss said state regulators have done a superior job in regulating the product and there is no need for a change now.

The rule is set to take effect in 2011. Poolman said it cost the industry about $100 million to transition to the new jurisdiction. ■

— Steve Tuckey

Welcome, new members!

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Talk About Volatility!

Number of times in 2008 that the S&P 500 closed up or down 5 percent in a single day: 17

Number of times between 1956 and 2007 it did this: 17

— "Harper's Index," Harper's Magazine

IRES 2009 Commissioner Guide

State	Commissioner	Appointed or Elected	Phone
AK	Linda Hall	Appointed	907-269-7900
AL	Jim L. Ridling	Appointed	334-269-3550
AR	Jay Bradford	Appointed	501-371-2600
AS[a]	Dr. Laloulu Tagoilelagi	Appointed	684-633-4116
AZ	Christina Urias	Appointed	602-364-3100
CA	Steve Poizner	Elected	916-492-3500
CO	Marcy Morrison	Appointed	303-894-7499
CT	Thomas R. Sullivan	Appointed	860-297-3800
DC	Thomas E. Hampton	Appointed	202-727-8000
DE	Karen Weldin-Stewart	Elected	302-674-7300
FL	Kevin McCarty	Appointed	850-413-5914
GA	John Oxendine	Elected	404-656-2056
GU[a]	John Camacho	Appointed	671-635-1817
HI	J.P. Schmidt	Appointed	808-586-2790
IA	Susan Voss	Appointed	515-281-5705
ID	William W. Deal	Appointed	208-334-4250
IL	Michael McRaith	Appointed	217-785-4515
IN	Jim Atterholt	Appointed	317-232-2385
KS	Sandy Praeger	Elected	785-296-3071
KY	Sharon P. Clark	Appointed	502-564-3630
LA	James J. Donelon	Elected	225-342-5423
MA	Nonnie Burnes	Appointed	617-521-7794
MD	Ralph S. Tyler, III	Appointed	410-468-2090
ME	Mila Kofman	Appointed	207-624-8475
MI	Ken Ross	Appointed	517-373-0220
MN	Glenn Wilson	Appointed	651-296-4026
MO[b]	John Huff	Appointed	573-751-4126
MS	Mike Chaney	Elected	601-359-3569
MT	Monica Lindeen	Elected	406-444-2040

NC	Wayne Goodwin	Elected	919-733-3058
ND	Adam Hamm	Elected	701-328-2440
NE	Ann Frohman	Appointed	402-471-2201
NH	Roger A. Sevigny	Appointed	603-271-2261
NJ	Steven M. Goldman	Appointed	609-292-7272
NM	Morris J. Chavez	Appointed	505-827-4601
NV	Scott J. Kipper	Appointed	775-687-4270
NY	Eric Dinallo	Appointed	212-480-2301
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WA	Mike Kreidler	Elected	360-725-7000
WI	Sean Dilweg	Appointed	608-266-3585
WV	Jane L. Cline	Appointed	304-558-3354
WY	Ken Vines	Appointed	307-777-7401

[a] AS: American Samoa; GU: Guam; PR: Puerto Rico; VI: Virgin Islands

[b] At press time, this person was serving in an "Acting" capacity.

Source: National Association of Insurance Commissioners. Index is current as of February 2009.

Individual state Web site addresses available via www.naic.org. Prepared by Kathleen McQueen.

IRC Study

Rise in Jobless Likely to Boost Auto Uninsured Rates

by Wayne Cotter, Editor

Despite the enactment of the $787 billion federal stimulus package last month, most economists expect the unemployment rate to rise in the months to come. In February 2009, the rate stood at 8.1%, its highest level since December 1983. As a result, it's not surprising that some drivers are dropping or scaling back their auto insurance coverage.

But now, for the first time, the Insurance Research Council (IRC) has quantified the correlation between unemployment and uninsured motorists. As a result, the organization estimates — based on current unemployment rate projections — an uninsured rate of 16.1% by 2010, up from the 13.8% in 2007. Supported by leading property/casualty insurance organizations, IRC conducts research on public policy issues affecting risk and insurance.

The IRC study, *Uninsured Motorists, 2008 Edition*, indicates that a 1.0 percentage point increase in the unemployment rate lifts the uninsured motorist rate by about three-quarters of one percentage point.

> ***"The IRC study indicates that a 1.0 percentage point increase in the unemployment rate lifts the uninsured motorist rate by about three-quarters of one percentage point."***

A commensurate rise in the uninsured rate would further strain the private passenger auto market by increasing the costs of uninsured motorist (UM) coverage. Drivers purchase UM coverage to protect themselves in the event they are injured as a result of an uninsured driver's negligence.

The IRC projections linking unemployment and uninsured drivers dwarfed the report's one glimmer of good news: the uninsured rate in 2007 was 13.8%, down from 14.9% in 2003. Of course, the subprime mortgage crisis was in its early stages in 2007 and employment levels had yet to be significantly impacted. The magnitude of the uninsured motorist problem varied widely from state to state according to the IRC report. With a 1% uninsured rate in 2007, Massachusetts led all states, followed by Maine (4%), North Dakota (5%), New York (5%), and Vermont (6%). At the bottom of the pack was New Mexico with a 29% uninsured rate, followed by Mississippi (28%), Alabama (26%), Oklahoma (24%), and Florida (23%).

A state-by-state breakdown of uninsured rates from the IRC study appears on p. 13.

Each year, the Council estimates the percentage of each state's uninsured driving population by using a ratio of insurance claims made by individuals who were injured by uninsured drivers to claims made by individuals who were injured by insured drivers.

The New York Experience

John Reiersen,* President of Commercial Mutual Insurance Company, says he is not surprised by New York's fourth-place finish or its 5% uninsured rate. Uninsured claims have been "dropping like a rock" for years in New York, he says. "Not only have uninsured motorists' claims and rates been going down," says Reiersen, "but the state agency that pays claims for pedestrians injured by uninsured drivers has seen its claims decline and uninsured motorist arbitrations under the no-fault system have also fallen."

Reiersen cites an electronic notification system as one major reason for the state's stellar performance. A version of the system, introduced in the 1980s, made New York the first state to require insurers to electronically report terminations of insurance to the New York State Department of Motor Vehicles (DMV), which would then verify with drivers whether new coverage had been secured.

The law was considerably strengthened as a result

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* John Reiersen is also a former New York insurance regulator and an IRES founding father.

of legislation that took effect in 2000. Under the new, beefed-up law, called the Insurance Information & Enforcement System (IIES), insurers are not only required to report to the DMV all those that drop coverage, *but also those that add coverage*. As a result, once the DMV system records a "drop" from one carrier, it looks for an "add" from another. If no "add" is located within two weeks, a letter to the driver is generated requesting proof of coverage.

A driver choosing to ignore the letter will have his registration suspended and be subject to a fine for each day that coverage is not in place. The driver is also directed to turn in the vehicle's license plates to the DMV.

If the unregistered driver were to be stopped by a law enforcement officer, the car would be impounded. When the lapse of coverage extends to 90 or more days, the individual's driving license is suspended.

It took a coordinated effort by New York State's Insurance Department, Department of Motor Vehicles, and law enforcement agencies to make such a program work, says Reiersen. He notes that although California has a similar reporting system, it has failed to enforce the law to any meaningful extent. With an 18% uninsured rate, California was ranked 7^{th} from the bottom in the IRC study. "New York has probably done the best job of any state," says Reiersen, "in enforcing its uninsured motorists law."

The industry traditionally opposes such laws, says Reiersen, because of the electronic reporting demands that such programs place on companies. "It's true," says Reiersen, "that initially this type of program takes a lot of work to comply with, but once an insurer's reporting system is up and running, it's an extremely effective tool."

Reiersen notes that carriers generally oppose mandatory automobile insurance laws so there is a consistency to their opposition to electronic reporting laws. He believes their opposition to mandatory automobile insurance laws — which are in place in the vast majority of states — stems from the tendency of states with such laws to establish residual markets for those drivers who cannot obtain coverage through the private, voluntary market. Such residual markets are often subsidized by higher rates for drivers in the voluntary market.

Estimated Percentage of Uninsured Motorists, by State, 2007

State	Rate	State	Rate	State	Rate
New Mexico	29%	Montana	15%	Kansas	10%
Mississippi	28	Colorado	15	Connecticut	9
Alabama	26	Washington DC	15	Virginia	9
Oklahoma	24	Indiana	14	South Carolina	9
Florida	23	Missouri	14	Idaho	9
Tennessee	20	Rhode Island	14	Wyoming	9
California	18	Alaska	13	New Jersey	8
Arizona	18	Maryland	12	Utah	8
Michigan	17	Hawaii	12	Nebraska	8
Washington	16	Louisiana	12	West Virginia	8
Ohio	16	Iowa	12	Pennsylvania	7
Kentucky	16	Minnesota	12	South Dakota	7
Texas	15	North Carolina	12	Vermont	6
Nevada	15	Georgia	12	New York	5
Arkansas	15	New Hampshire	11	North Dakota	5
Wisconsin	15	Oregon	11	Maine	4
Illinois	15	Delaware	10	Massachusetts	1

Reiersen says he has no doubt that policyholders will be dropping coverage if the unemployment rate continues to rise over the coming months. "We already see policyholders scaling back coverage to the minimum bodily injury limits of $25,000 per person/$50,000 per accident level from $100,000/$300,000 or $250,000/$500,000 levels," says Reiersen. "If your assets are depleted and you can't pay your mortgage, what are higher limits protecting?"

continued on next page

Joblessness may increase auto insurance rates

continued from previous page

A Larger Question

Robert Hunter, Director of Insurance for the Consumer Federation of America, says there is "no doubt" that hard economic times will increase the number of uninsured drivers on our nation's highways. "Automobile insurance," says Hunter," is one of those items that a driver will duck during times like these."

But a larger question looms, says Hunter, namely: Why an industry-supported research group doesn't look into other, more controversial issues such as the impact of the economic meltdown on credit scores? Lower credit scores can mean higher insurance premiums for consumers in states in which insurers are permitted to use such scores for underwriting and rating.

"There are a lot of excellent drivers out there," says Hunter, "who through no fault of their own have lost their jobs and homes and will now have lower credit scores and higher insurance costs. Why doesn't the industry study that?"

Hunter also asks, "Why doesn't the IRC study the fact that while lower credit scores should imply higher accident and death rates, in today's economy we see lower scores and a sharply *lower* accident/death rate. Doesn't this imply that credit scoring doesn't work?"

To order a copy of the IRC report, visit **www.ircweb.org.** ■

Long of NC: 'Zealous advocate for consumers'

IRES and the nation's insurance regulatory community mourns the loss of longtime North Carolina Insurance Commissioner Jim Long, who passed away Feb. 2. He was 68.

Long recently retired after 24 years at the helm of the North Carolina Department of Insurance. In recognition of his many achievements, Long was presented with the inaugural President's Award for Distinguished NAIC Member Leadership during the NAIC 2008 Winter Meeting. Mr. Long frequently spoke at IRES meetings and seminars.

NAIC Secretary-Treasurer and Florida Insurance Commissioner Kevin McCarty called Mr. Long "a zealous advocate of consumer protection issues."

NAIC President-Elect and West Virginia Insurance Commissioner Jane Cline noted that, "Jim was a stickler for procedure but he always knew how to have fun. Even though he was very busy with his own responsibilities and accomplishments, he always remembered everyone and enjoyed seeing others achieve whatever their potential allowed."

Susan Voss, NAIC Vice President and Iowa Insurance Commissioner, added: "Jim always had time to discuss the issues and help you through difficult situations. He handled it all with grace and a sense of humor that will be missed by so many of us.

"I cannot believe that this kind gentleman is gone. The NAIC and all commissioners have lost a dear friend. There will be a little less laughter at our meetings — but I know he's already telling jokes to St. Peter."

IRES Chapter News

COLORADO — In January, **John Berino**, a fire safety professional, presented information regarding wildfire mitigation and related claims involved with fighting the super fires that occur in densely forested areas. John also discussed the complexities of investigating wildfires, man-made fires, and those caused by natural events such as lightning.

In February, **Jim Hertel**, an HMO newsletter publisher, discussed HMOs and emerging trends and future challenges. Also, **Janet Byrne** from Pinnocal Assurance outlined the challenges and advantages of Sarbanes-Oxley (SOX) compliance.
— Tom Abel; Tom.Abel@dora.state.co.us

LOUISIANA — Seven members attended the State Committee Meeting on January 14. Agenda items included the Secretary's and Treasurer's reports; IRES updates and annual dues reminders; a discussion of future speakers for Chapter meetings; and reports on Chapter and national member changes.

In addition, two proposals were voted on: (1) discontinuing the annual dues for the Chapter; and (2) changing our meeting day to Monday from Wednesday to enable more members to attend. Both proposals passed.
— Larry Hawkins; lhawkins@ldi.state.la.us

WISCONSIN — Welcome to our new State Chapter Chairperson, **Lynn Pink**. Lynn has worked for the Wisconsin Office of the Commissioner of Insurance (OCI) since 2007 and joined IRES last year. She has prior regulatory experience with Wisconsin's Bureau of Consumer Protection.
— Ashley Natysin; ashley.natysin@wisconsin.gov

"Quote of the Month"

The economy is in crisis. We thought the enemy was Mr. Madoff. I think it's you.

— U.S. Representative Gary Ackerman (D-NY) during a Congressional hearing that focused on how the SEC managed to ignore nine years of warnings from Harry Markopolos about Bernard Madoff's investment schemes. Rep. Ackerman's remarks were directed to SEC enforcement chief Linda Chatman Thomsen and acting general counsel Andrew Vollmer after they repeatedly informed the panel that they were not able to answer questions due to an ongoing investigation of the matter by the agency's inspector general.

Regulatory Roundup

by
Stroock & Stroock & Lavan LLP

Connecticut — Bill expanding Connecticut's Unfair Insurance Practices Act introduced

On January 28, Senate Bill 763, An Act Concerning the Connecticut Unfair Insurance Practices Act (the "Act") was introduced. The Bill, if enacted, would lower the standard for violations under Connecticut's Unfair Insurance Practices Act. Currently under the Connecticut statute, an action for unfair claim settlement practices could only be initiated if the practice was committed "with such frequency as to indicate a general business practice."

The Bill removes this standard, thereby permitting a new private cause of action for unfair claim settlement practices without the necessity of showing a general business practice on the part of an insurer. SB 763 would also permit any person who suffers an ascertainable loss to bring an action in the judicial district in which the plaintiff or defendant resides or has his principal place of business or is doing business.

Proof of public interest or public injury would not be required, and the court may, in its discretion, award punitive damages. The Bill was referred to the Committee on Insurance and Real Estate, and if passed, would become effective on October 1, 2009. To view SB 763, visit the Connecticut General Assembly's Web site at **www.cga.ct.gov**.

New York – Insurance Department issues draft broker disclosure regulation

The New York Insurance Department issued a new draft Regulation (11 NYCRR Part 30) intended to create transparency of compensation paid to insurance producers by establishing minimum disclosure requirements relating to the role of the producers and the actual or potential conflicts of interest created by compensation paid to such producers. Under the draft Regulation, producers must provide written disclosure to the purchaser describing the nature and amount of the compensation the producer will receive from the insurer writing the policy, as well as any material ownership interest between the producer and the insurer.

The required notice must also disclose that a producer may have incentives to recommend a particular insurance policy based on the amount of compensation paid in connection with that policy and that a purchaser has a right to receive information from the producer about any quotes or alternative policies the producer considered and the relative amounts of compensation the producer would have received in connection with those quotes or alternatives. If the amount or value of compensation is not known at the time of sale, the notice may describe the method of calculating the compensation, including factors on which compensation is based such as volume, profitability and retention, and a reasonable estimate of the amount or value. These requirements, however, do not apply to the placement of reinsurance, insurance with a captive insurance company or a broker that has no contact with the purchaser, which may include wholesale brokers or managing general agents.

The draft Regulation also requires authorized insurers to maintain a producer file that includes the amount of compensation the insurer or its agent pays to an insurance producer and the reasons for such compensation. The draft Regulation becomes effective upon publication in the State Register. To view the draft Regulation, visit the New York Insurance Department's Web site at **www.ins.state.ny.us**.

Oregon – Bill controlling use of credit history in rerating policies is introduced

The Oregon Senate is considering a bill (SB 377) that would prohibit an insurer that issues personal insurance

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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.

policies in the state from increasing premiums after rerating a consumer at the consumer's request.

Under existing Oregon law an insurer may use a consumer's credit history to decline coverage of personal insurance in the initial underwriting decision, but only in combination with other substantive underwriting factors. SB 377 would give consumers the right to request, no more than once annually, that the insurer rerate them according to those standards the insurer would apply if the consumer were initially applying for the same personal insurance. Regardless of results, the insurer may not use the rerated information to increase a consumer's premium and, if the consumer qualifies for a more favorable rating category, the insurer would be required to reduce premiums. SB 377 applies only to personal insurance policies issued or renewed on or after the effective date of the Bill. To view SB 377, visit the Oregon State Legislature's Web site at **www.leg.state.or.us**.

New Jersey – Assembly passes Interstate Insurance Compact

On February 5, the New Jersey Assembly passed A2614, the Interstate Insurance Product Regulation Compact Act, thereby becoming a member state of the Compact, a multi-state entity created to develop uniform standards for insurance products and establish a central clearinghouse to provide prompt review and approval of insurance products covered under the Compact.

The Compact established a multi-state public entity called the Interstate Insurance Product Regulation Commission (the "Commission"), which serves as an instrumentality of the member states by acting as a central point of electronic filing for certain insurance products, including life insurance, annuities, disability income and long-term care insurance. Any insurance product approved by the Commission may be sold or otherwise issued in those compacting states for which the insurer is legally authorized to do business.

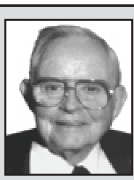
The Compact permits a compacting state to "opt out" of certain uniform standards, and provides that a state may prospectively opt out of all uniform standards pertaining to long-term care insurance products. New Jersey elected to opt out of any future uniform standards established by the Commission with respect to long-term care insurance products because it has previously enacted the "New Jersey Long-Term Care Insurance Act" P.L.2003, c.207 (C.17B:27E-1 et seq.).

According to the Commission's Web site, since meeting its operational threshold in May 2006, the Compact now has 33 member states. To view A2614, visit the New Jersey Legislature's Web site at **www.njleg.state.nj.us**.

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

This summer, six positions come open on the IRES Board of Directors. Elections will be held in August during the 2009 CDS in Baltimore. There are also one-year positions the Board may fill when it meets in Baltimore.

If you are interested, e-mail Larry Hawkins at: **lhawkins@ldi.state.la.us**. Request a nomination form. Or contact the IRES Office: ireshq@swbell.net. or (913) 768-4700.



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Casual Observations

Heroes of the Financial Crisis

You may have heard that *Time* recently published its list of the 25 people most responsible for the financial meltdown. What you may not know is that the magazine is also conducting an online poll to determine who readers think are the most culpable. As of early March, former U.S. Senator and deregulator *extraordinaire* Phil Gramm topped the list, followed by former Securities & Exchange Commission (SEC) Chairman Christopher Cox and Countrywide co-founder Angelo Mozilo.

The villains in this crisis are beginning to resemble the multiple suspects in "Murder on the Orient Express." Each stuck in the knife, but who delivered the lethal thrust?

Along with these villains, however, a smaller group of heroes has emerged. Some are from bygone eras, but their past efforts have helped us understand the current crisis. Others have surfaced over the past few months. Below are a few of our *heroes of the financial crisis.*

• **Ferdinand Pecora**: In early 1933, in the waning days of the Hoover administration, the Senate Banking and Currency Committee held hearings that focused on the origins of the Great Depression. Ferdinand Pecora — a cigar-chomping, former New York assistant district attorney — was the Committee's chief counsel and essentially ran the show. Pecora mercilessly grilled the era's top financial titans over a two-year period. As a result, the nation learned that Wall Street's biggest firms had been involved in a series of fraudulent schemes that helped usher in this country's most severe economic collapse. Pecora's work spurred significant financial reform, including the Glass-Steagall Act of 1933 and the Securities Exchange Act of 1934.

• **Mancur Olson**: Mancur Olson, who died in 1982, was a University of Maryland economist who authored three highly influential books. The second, published in 1982, *The Rise and Decline of Nations*, argues that the longer a country enjoys political stability, the more influential special interest groups — such as steel producers and labor unions — become. As a result, these groups end up benefiting a small number of members at the expense of the general public. This invariably leads, Olson wrote, to a nation's economic decline. Some policymakers, recognizing the lobbying muscle of the financial services industry, have begun revisiting Olson's groundbreaking work.

• **Harry Markopolos**: For nine long years, Harry Markopolos, a Certified Financial Analyst, tried to convince the SEC to pull the plug on Bernard Madoff's $50 billion Ponzi scheme, only to be rebuffed time and time again. In his 375-page testimony to Congress last month, Markopolos placed the blame for failing to uncover the scheme squarely on the SEC, saying its investigators "clearly don't comprehend the frauds of the 21st century." SEC investigators are mostly attorneys, said Markopolos, who lack market savvy. His suggestion? Bring in experienced traders who can spot wrongdoing and provide them with financial incentives for nabbing the bad guys.

• **Andrew Cuomo**: New York's Attorney General led the U.S. Department of Housing and Urban Development (HUD) during the Clinton administration and some claim his efforts to increase the number of subprime mortgages purchased by Freddie Mac and Fannie Mae contributed to the current crisis. However, as Attorney General, Cuomo has launched aggressive investigations into short selling, credit default swap trading activity, and the excessive executive bonuses paid to recipients of public funds.

•**Insurance Regulators**: If *Time* can name "The American Consumer" as one of the chief culprits behind this economic crisis, we think we can name "Insurance Regulators" as one of the heroes. After all, in the vast financial services edifice, it is the insurance pillar that stood the strongest. Sure, the financial crisis has exposed vulnerabilities in the insurance regulatory process, but these are mere trickles compared to the flood of federal lapses. The feds should be looking to state insurance departments for regulatory lessons rather than seeking to usurp their authority.

— W.C.

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

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

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Using the back door for reserve relief. *Story, p. 1*

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.

√ IRES extends deep appreciation to Patrick Smith, Joy Little, and the Smith-Little consulting firm of Charleston, WV, for its pro bono financial review of the Society's records and books for 2008. This represents an exceptional donation of time and talent and a significant costs savings for the Society.

√ 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:

A Fresh Look at Annuities

Florida Homeowner Woes

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.