

# The Regulator<sup>®</sup>

INSURANCE REGULATORY EXAMINERS SOCIETY

## *Homeowners' Insurance*

### Revamping Florida's Insurer of Last Resort

by *Steve Tuckey*.

Special to *The Regulator*

**A**s the June 1 start of the hurricane seasons draws near, all eyes will turn to Florida policymakers to see what they will do to ensure a repeat of the catastrophic 2004-05 seasons does not wipe out insurers and homeowners alike.

As of press deadline for this article, lawmakers are attempting to hammer out some sort of rate increase for Citizens Property Insurance Corporation policyholders, who have enjoyed a rate freeze for the past three years, and cut back on the exposure of the Florida Hurricane Catastrophe Fund (FHCF). The FHCF, which can be loosely described as a reinsurance facility, was created in 1993 to provide reimbursements to insurers for a portion of their catastrophic hurricane losses.



Lawmakers are attempting to undo a series of measures passed in the 2007 session aimed at suppressing rates that would have shot up in the aftermath of the 2004-05 seasons.

Citizens was created in 2002 as the property insurer of last resort as a result of the merger of two existing associations with the aim of providing coverage to applicants unable to obtain it in the private market. But over the years affordability became as important a factor in granting coverage as availability, and as a result the corporation has grown to the extent that it troubles many of the state's policymakers.

According to figures provided by Citizens, the corporation itself covers 27% of the state's personal homeowners' policies, Florida-only subsidiaries cover 38%, and Florida domestics cover 16%. Other national companies, such as USAA, cover the balance.

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## The Golden Age of Financial Regulation?

by *Kevin Foley*

Last month, President Obama, with the Secretary of the Treasury by his side, stood in London among leaders of the other major national economies and pledged to develop a broad new American system of regulation designed to protect the world from the financial system abuses that have brought us to the crater's edge of a depression.

While the president apologized for America's role in creating the crisis, he declined to support a European proposal for a planetary regulator. In return the Europeans refused to pledge new stimulus efforts similar to the American program. Underlying the thin diplomatic bargains ultimately struck was a challenge to the U.S. to definitively demonstrate its resolve to reform its financial system before greater international economic cooperation is offered.

Does this mean a golden age of U.S. financial regulation is

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 **MAY 2009**

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## From the President

### Are You Baltimore Bound?

The 2009 IRES Career Development Seminar (CDS) is just around the corner. As many of you know, the CDS is the Society's flagship educational event. This year the CDS – August 9 through 11, 2009 – will be held in the spectacular Inner Harbor of Baltimore, Maryland.



I've attended the CDS just about every year since 1994. Each year I marvel at how the CDS team is able to put together such an amazing event, packed with so many quality sessions on such a wide range of hot topics and current issues, touching on so many aspects relevant to the business of insurance regulation.

This year the CDS once again features an abundance of timely and informative sessions, designed to give you information you can use to be a better regulator or compliance professional. Thanks to the dedication and hard work of the 2009 CDS crew, Dennis C. Shoop, MCM, the 2009 Education Committee Chair, CDS Co-Chairs Stephen M. Martuscello, CIE, and Dudley B. Ewen, AIE, and our CDS Section Chairs, the 2009 CDS is sure to help you navigate the uncharted waters of insurance regulation.

This year, the CDS officially kicks off with a panel on Health Insurance moderated by Maryland Insurance Commissioner Ralph Tyler featuring U.S. Senator Benjamin L. Cardin (D-Maryland) and John M. Colmers, Secretary of Maryland's Department of Health & Mental Hygiene. Don't miss this exciting

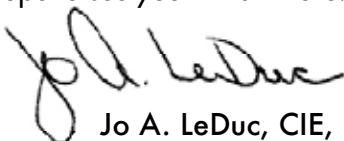
opportunity to hear some perspectives about health care reform from high-ranking officials both inside and outside of the insurance regulatory arena.

Of course the CDS will again offer sessions geared to consumer service representatives, market conduct examiners, financial examiners, market analysts, enforcement and compliance professionals, and rate/form analysts. New this year is a series of sessions devoted to the use of technology in the market conduct examination process. Whether you are looking for an overview of the technology in the present day exam or for specific information on working with TeamMate, this group of sessions is sure to give you the information you need.

The CDS will also include the usual opening night reception where you can socialize and network with fellow regulators, plus we added a few extras this year. The Membership & Benefits Committee has organized an outing for Monday evening to see the Baltimore Orioles take on the Oakland A's. Even if you're not a baseball fan, a visit to Camden Yards — the beautiful home of the Orioles — is well worth it. The Committee will also be selling IRES logo wear and a cookbook ("Taste of IRES") featuring recipes from members across the country. Visit the CDS page of the IRES Web site ([www.go-ires.org](http://www.go-ires.org)) for additional information.

By now you should have received the advance CDS program with all the details. Please take a moment to look at the program and all that the CDS has to offer. Everything you need to know about the CDS is also posted on our Web site. Attending the CDS is truly a great way to invest in your future. Book now!

I hope to see you in Baltimore.



Jo A. LeDuc, CIE, MCM  
IRES President

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## Looking back?



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Visit [www.go-ires.org](http://www.go-ires.org)

# Homeowners revamp in Florida

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A consensus seems to exist for allowing some sort of rate increase for Citizens, as an attempt to extend the freeze one more year went nowhere earlier this year. And simply allowing the freeze to expire could result in Citizens being forced to ask for rate increases that some people think could be in the 15%-20% range in the first year if the company is to meet its requirement for providing actuarially sound increases in its mandated July 15 filing with the state's Office of Insurance Regulation.

## Returning to original role

Liz Reynolds, regional representative for the National Association of Mutual Insurance Companies, said she hopes that Citizens is placed on the so-called "glide-path" of rate increases over the next three years not only to make it actuarially sound, but also return the entity to its original role of insurer of last resort.

"There have been some efforts in the depopulation arena for the past several years with the takeout companies that have been formed. But there is no one thing, no one silver bullet that will solve the problem," she said.

While Citizens' depopulation efforts over the past few years have been moving forward somewhat, they were stymied by the rate freeze. Until 2002, applicants had to prove they could not obtain coverage from any other company. But the policy was changed to allow them in if they could show the coverage they could obtain was 25% above Citizens' rates, a figure soon reduced to the current 15% benchmark.

Scott Johnson, executive director for the Florida Association of Insurance Agents, said that Citizens' rate inadequacy has been reaching the point where it has become dangerous. As for the role of the agents in depopulation, a 2002 proviso permitted a Citizens' policyholder to decline coverage from a takeout company if his or her agent was unable to accept an appointment to that company. In 2007, the policy was further amended to allow Citizens' policyholders to opt

out of coverage from a takeout company, regardless of the status of the agent. "So lawmakers opened it all up, so anybody can stay in Citizens if they want to," he said.

Johnson said that as a result of the so-called consumer choice provisos, the depopulation effort chalked up one of its most successful years in 2008.



Out of the 418,101 policies selected for takeout company assumption, only 33,017 policyholders chose to opt out and remain with Citizens after other carriers had notified them that they were willing to issue policies. While Citizens will always retain some advantage with its state backing and claims-paying history over start-ups, Johnson said that last year's depopulation success could be attributed to agents realizing that perhaps it was not the wisest course of action to have the state assume such a huge liability.

Raising Citizens' rates will of course raise the 15% benchmark and will therefore serve to spur further depopulation efforts. Earlier this year, a Citizens Mission Review Task Force recommended strict enforcement of the 15% rule for new applicants, but in its report admitted there was no way of knowing how many applicants received coverage without providing proof of the mandated higher offers. "In the end it is all driven by rates," Johnson said.

Citizens spokesman John Kuczanski noted that new efforts have been undertaken to ensure that Citizens' customers do not find themselves taken out

inadvertently from the company. But he stressed that its policyholders should seriously consider any takeout offer due to a new layer of assessments they face in the event of a catastrophe that exceeds fund reserves.

### **Reducing reinsurance fund exposure**

Lawmakers are also attempting to cut back on the state's reinsurance fund exposure following its increase of \$12 billion of capacity in 2007. That move was an attempt to provide primary insurers with the coverage they need to meet regulatory and rating agencies' solvency requirements, much to the chagrin of the traditional reinsurance industry.

Today, it is generally agreed that the FHCF is about \$18 billion short of its liabilities and is not able to make it up due to the constriction of the capital markets in the current economic crisis. The Florida legislators face a number of unpalatable choices, according to William Stander, Tallahassee-based assistant vice president for the Property Casualty Insurers Association of America.

"The most likely scenario will be for the legislators to somehow slowly shrink the liability of the FHCF," Stander said.

Primary insurers will then face rating agency pressure to make up that lost capacity in the private marketplace, and so the question then becomes whether regulators will allow companies to pass on those increased costs. If the current wrangle over the exit terms of State Farm leaving the state is any indication, that scenario seems unlikely.

Florida Gov. Charlie Crist could then attempt some sort of pre-event financing like Florida did last year when it purchased a \$224 million financial instrument from Warren Buffett allowing access to billions in case of a catastrophe. "But that would cost a lot more than \$224 million this year," said Stander.

Florida policymakers can only hope for a repeat of last year when the state did not even rank in the top five in terms of catastrophic losses to residents and businesses. Last year, Texas led the way with \$10.2 billion in losses followed by Louisiana with \$2.2 billion and Minnesota with \$1.6 billion.

Florida's Chief Financial Officer Alex Sink, said to be a leading Democrat to oppose Crist in next year's

election, called for elimination of the 2007 \$12 billion Temporary Insurance Coverage Layer (which provided additional capacity to the FHCF), noting that one major storm would currently leave state residents on the hook for special assessments for three decades, with little flexibility to cope with future catastrophes. She also called for Citizens to once again become the insurer of last resort through not only gradual rate increases, but also by prohibiting it from insuring any new coastal development.

Meanwhile, State Farm's plan to withdraw from Florida's homeowners' market seems to have shaken up some policymakers, although to what extent is difficult to determine. The Florida subsidiary and the Office of Insurance Regulation are currently in a tussle over the precise terms for the company's exit with the state trying to make sure that the lion's share of the customers do not end up on Citizens' rolls.

A provision allowing private insurers to raise rates up to 8% without prior approval has received a mixed reaction as the session draws to a close with a House panel approving but its Senate counterpart denying it. Robert Hunter, insurance director for the Consumer Federation of America, called the so-called "flex band" a "foolish and dangerous idea." Said Hunter, "It is simply a gift to insurers and will result in higher rates for everyone in the state."

Some state activists and lawmakers are looking to pre-event financing for wind peril as one solution to the problem of catastrophe risk. Legislation with bipartisan support would create a tax-exempt state fund to house and more efficiently build up billions of dollars in hurricane premiums that state residents pay each year with private insurers covering all non-wind risk. Shield Our State organizer Dan Montgomery said that the state's hurricane risk is too large for either the state or private industry to handle alone and that a public-private partnership is the answer. He believes the measure will result in a stabilization of property rates as well as a return of private insurers to the state. ■

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

# Savannah Market Regulation School



Private appointments with regulators are a hallmark of the school.

Nearly 200 insurance executives, lawyers, and state regulators came to Savannah, GA, May 3-5 for the 2009 National Insurance School on Market Regulation.

Guest speakers included John Oxendine, Georgia Commissioner of Insurance (bottom left, this page) and New Hampshire Insurance Commissioner Roger Sevigny (top right, facing page).





NAIC President and New Hampshire Commissioner Roger Sevigny provided a keynote address

## NAIC's Mullen Receives Teaching Award

SAVANNAH, Ga. — Tim Mullen, Director of the Market Regulation Division at the NAIC is the recipient of the IRES Foundation's Paul L. DeAngelo Memorial Teaching Award.

A 20-year veteran of the insurance regulatory field, Mullen is a frequent presenter at the Foundation school as well as the IRES Career Development Seminar, and NAIC education programs

Foundation Board Member John Mancini noted that Mullen, " ... is known to all as someone who willingly makes time to share knowledge, and is always willing to listen." Mancini added that Mullen "has been directly involved in orchestrating the most important NAIC market conduct initiatives that have been introduced and has been a leader in implementing those initiatives."

The award is named after the late Paul L. DeAngelo, longtime New Jersey insurance regulator and frequent presenter at the Foundation's Market Conduct School.



Tim Mullen (left) with Foundation Board Member John Mancini



# Is the Golden Age of Financial Regulation Upon Us?

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upon us? Are we on the cusp of a time when all our financial markets, all companies and all transactions will be subject to new laws and more extensive rules enforced by a newly empowered cadre of regulators? Will we see far greater transparency of the machinery of hedge funds and other opaque investment vehicles as well as assets held in banks? Will the language of retail transactions such as mortgages, credit cards and insurance policies be made simpler and clearer? All this and perhaps a hotline number to report violations both big and small?

No one can say for sure what is going to happen in the months ahead but certainly the U.S. government will enlarge the scope of its oversight of the domestic economy and in particular the financial services sector. A codification of new powers, some already on haphazard display, will mean an historic rebuke of the free market ideology, which has prevailed over regulatory matters for decades. Of course, as every regulator past or present knows, the details are what matter. And before the details are written the politics of the current crisis have to play out.

## **Ambitious Thinking**

The Obama administration has displayed an appetite for ambitious thinking on a number of fronts (health care, education, energy) and we should expect no less when it comes to a new regulatory scheme for the financial marketplace. But while broader and deeper regulatory powers might appeal to strong-willed executive branch leaders and the permanent civil service, not to mention an angry, wounded public, it is in Congress that the structure and extent of any regulatory authority will be finally determined.

And while much has been made of the failure of government institutions to monitor the economy's security and protect investors from dramatic losses, Congress hasn't reflected much on its own role. Rather we have seen a blizzard of press conferences attacking opportunistic targets (AIG bonuses) and a series of hurried hearings revealing the institution's weak bench

when it comes to financial matters, rather than any deep insight into how we got here or the way forward.

When it has a mind to Congress can perform the important function of searching for the causes of a crisis to lay the foundation for comprehensive reform. In the 1930s the Senate Banking and Currency Committee held a series of investigative hearings that dug deep and asked tough, informed questions of a lot of people at different levels in the financial world. The findings generated the public support

and momentum necessary for significant legislative change. Although a number of corporate chieftains have recently found themselves in the Congressional dock for a brow beating, we have yet to see a resolve to thoroughly examine how, for instance, a multitude of fraudulently originated mortgages were spun into highly rated

bundled assets then sold worldwide. Or how those assets resulted first in extraordinary payouts to a relatively select class of people but later threatened the entire economic system. And then there is AIG.

## **Bipartisan Squeamishness**

Is it cynical to suggest that bipartisan squeamishness over the roles played by elected and appointed officials past and present in creating such a hothouse atmosphere might put a damper on a sustained search for answers? The president, who has appointed several experienced senior economics officials who, some have argued, helped create the conditions for the crisis, has already shown he has little enthusiasm for historical investigations when it comes to the Bush administration's anti-terrorism policies.

Our political system runs largely on money, timing and public perceptions filtered through the 24-hour Internet-driven news media. There are members of Congress who have the intelligence and commitment to help drive a new regulatory scheme designed to avoid the abuses of the past. None of them can act outside the rules of the road, however. And the first rule is to raise sufficient campaign funds to fend off opponents in your district. Even in its weakened, chastised state, the financial services industry remains a verdant field for

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***Under any scenario there will be stricter regulation of risk taking and complex investment vehicles.***  
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fundraising especially for those members with the most influence. Much has been said about limiting executive pay but little about prohibiting campaign contributions from regulated entities.

If the Dow is at 9,500 and the unemployment rate has inched downward when bills for financial reform come to the floor of Congress, attitudes may be more generous toward the industry, which will be fighting for latitude to find ways back to profitability. On the other hand, if the leading economic indicators are stuck in the mud and the public mood is restive, a different outcome can be expected. But the emphasis might still be on the appearance of toughness with limits on compensation and beefed-up enforcement with harsher penalties leading the way.

### Employment Opportunities

Under any scenario there will be stricter regulation of risk taking and complex investment vehicles. But the debate over the degree of government control and whether prior governmental approvals are required at any point will be interesting to watch unfold. There is likely to be an increase in employment opportunities for financial regulators but just how many jobs Congress will think are needed is an open question.

And to what extent will jobs in the insurance regulatory arena be included?

As this is written some large life insurance companies are reported to be lining up for federal TARP money to fend off solvency woes from guaranteed variable annuity commitments and a deep decline in their invested assets. This situation is but one in a host of regulatory issues specific to the insurance industry, a business Congress, the executive branch and the media know even less about.

Will the federal government lend life insurers money without significant new strings attached? Can some form of a national health insurance program be established without a new federal regulatory role for health insurers? Has the AIG disaster undermined Congressional and public confidence in state regulation enough to create a greater federal role, however unfair the assessment?

State governments, the NAIC and NCOIL are all prepared to disabuse their federal colleagues and

the media of the idea the states should forfeit any regulatory turf and the local jobs and tax income that come with it. By headquartering its new Chairman, Terri Vaughn, in Washington, the NAIC wants to make certain it is at the table when these issues come up. The organization will rightly argue that the insurance business in general is suffering no apparent greater stress than the economic system as a whole, due in great measure to the effectiveness of the state-based regulatory framework.

Members of Congress, many of whom are former state legislators, will be sensitive to the impact on their home states of any new federal insurance role.

And they are likely to be skeptical of the need for an even larger federal bureaucracy than the one they will be voting for to regulate the banks and hedge funds. Still, some of the larger insurers — both life and p&c — will be pressing (and contributing to campaigns) for either federal regulation or a charter option scheme.

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*Members of Congress, many of whom are former state legislators, will be sensitive to the impact on their home states of any new federal insurance role.*  
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AIG notwithstanding, unless there is a major insolvency followed by a failure of the state guaranty fund system to stem its effects, it is unlikely the insurance regulatory system (excepting health insurance) will be altered nearly as much as the banking and investment businesses. You can bet, however, on Congress and the executive branch trying to move financial services companies closer to their separate purposes as defined in the Glass-Steagall era which followed the Great Depression and away from the Gramm-Leach-Bliley financial supermarket idea of today. ■



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# Treading Cautiously Among the Monolines

by Warren Buffett

CEO and Chairman of the Board  
Berkshire Hathaway

Early in 2008, we activated Berkshire Hathaway Assurance Company (“BHAC”) as an insurer of the tax-exempt bonds issued by states, cities and other local entities. BHAC insures these securities for issuers both at the time their bonds are sold to the public (primary transactions) and later, when the bonds are already owned by investors (secondary transactions).

By yearend 2007, the half dozen or so companies that had been the major players in this business had all fallen into big trouble. The cause of their problems was captured long ago by Mae West: “I was Snow White, but I drifted.”

The monolines (as the bond insurers are called) initially insured only tax-exempt bonds that were low-risk. But over the years competition for this business intensified, and rates fell. Faced with the prospect of stagnating or declining earnings, the monoline managers turned to ever-riskier propositions. Some of these involved the insuring of residential mortgage obligations. When housing prices plummeted, the monoline industry quickly became a basket case.

Early in the year, Berkshire offered to assume all of the insurance issued on tax-exempts that was on the books of the three largest monolines. These companies were all in life-threatening trouble (though they said otherwise). We would have charged a 1.5% rate to take over the guarantees on about \$822 billion of bonds. If our offer had been accepted, we would have been required to pay any losses suffered by investors who owned these bonds – a guarantee stretching for 40 years in some cases. Ours was not a frivolous proposal: For reasons we will come to later, it involved substantial risk for Berkshire.

The monolines summarily rejected our offer, in some cases appending an insult or two. In the end,

though, the turndowns proved to be *very* good news for us, because it became apparent that I had severely underpriced our offer.

## “Second-to-Pay” insurance

Thereafter, we wrote about \$15.6 billion of insurance in the secondary market. And here’s the punchline: About 77% of this business was on bonds that were already insured, largely by the three aforementioned monolines. In these agreements, we have to pay for defaults *only* if the original insurer is financially unable to do so.

We wrote this “second-to-pay” insurance for rates averaging 3.3%. That’s right; we have been paid far more for becoming the second to pay than the 1.5% we would have earlier charged to be the first to pay. In one extreme case, we actually agreed to be *fourth* to pay, nonetheless receiving about three times the 1% premium charged by the monoline that remains *first* to pay. In other words, three other monolines have to first go broke before we need to write a check.

Two of the three monolines to which we made our initial bulk offer later raised substantial capital. This, of course, directly helps *us*, since it makes it less likely that we will have to pay, at least in the near term, any claims on our second-to-pay insurance because these two monolines fail. In addition to our book of secondary business, we have also written \$3.7 billion of primary business for a premium of \$96 million. In primary business, of course, we are first to pay if the issuer gets in trouble.

We have a great many more multiples of capital behind the insurance we write than does any other monoline. Consequently, our guarantee is far more valuable than theirs. This explains why many sophisticated investors have bought second-to-pay insurance from us even though they were already insured by another monoline. BHAC has become not only the insurer of preference, but in many cases the *sole* insurer acceptable to bondholders.

# Treading Cautiously Among the Monolines

## Exercising Caution

Nevertheless, we remain very cautious about the business we write and regard it as far from a sure thing that this insurance will ultimately be profitable for us. The reason is simple, though I have never seen even a passing reference to it by any financial analyst, rating agency or monoline CEO.

The rationale behind very low premium rates for insuring tax-exempts has been that defaults have historically been few. But that record largely reflects the experience of entities that issued *uninsured* bonds. Insurance of tax-exempt bonds didn't exist before 1971, and even after that most bonds remained uninsured.

A universe of tax-exempts fully covered by insurance would be certain to have a somewhat different loss experience from a group of uninsured, but otherwise similar bonds, the only question being *how* different. To understand why, let's go back to 1975 when New York City was on the edge of bankruptcy. At the time its bonds – virtually all uninsured – were heavily held by the city's wealthier residents as well as by New York banks and other institutions. These local bondholders deeply desired to solve the city's fiscal problems. So before long, concessions and cooperation from a host of involved constituencies produced a solution. Without one, it was apparent to all that New York's citizens and businesses would have experienced widespread and severe financial losses from their bond holdings.

Now, imagine that all of the city's bonds had instead been insured by Berkshire. Would similar belt-tightening, tax increases, labor concessions, etc. have been forthcoming? Of course not. At a minimum, Berkshire would have been asked to "share" in the required sacrifices. And, considering our deep pockets, the required contribution would most certainly have been substantial.

Local governments are going to face *far* tougher fiscal problems in the future than they have to date. The pension liabilities will be a huge contributor to

*continued on next page*

## Beware of Geeks Bearing Formulas

The type of fallacy involved in projecting loss experience from a universe of non-insured bonds onto a deceptively-similar universe in which many bonds are insured pops up in other areas of finance. "Back-tested" models of many kinds are susceptible to this sort of error. Nevertheless, they are frequently touted in financial markets as guides to future action. (If merely looking up past financial data would tell you what the future holds, the Forbes 400 would consist of librarians.)

Indeed, the stupefying losses in mortgage-related securities came in large part because of flawed, history-based models used by salesmen, rating agencies and investors. These parties looked at loss experience over periods when home prices rose only moderately and speculation in houses was negligible. They then made this experience a yardstick for evaluating future losses. They blissfully ignored the fact that house prices had recently skyrocketed, loan practices had deteriorated and many buyers had opted for houses they couldn't afford.

In short, universe "past" and universe "current" had very different characteristics. But lenders, government and media largely failed to recognize this all-important fact.

Investors should be skeptical of history-based models. Constructed by a nerdy-sounding priesthood using esoteric terms such as beta, gamma, sigma and the like, these models tend to look impressive. Too often, though, investors forget to examine the assumptions behind the symbols. Our advice: Beware of geeks bearing formulas.

— W. Buffett

# Treading Cautiously Among the Monolines

*continued from page 11*

these woes. Many cities and states were surely horrified when they inspected the status of their funding at yearend 2008. The gap between assets and a realistic actuarial valuation of present liabilities is simply staggering.

When faced with large revenue shortfalls, communities that have all of their bonds insured will be more prone to develop “solutions” less favorable to bondholders than those communities that have uninsured bonds held by local banks and residents. Losses in the tax-exempt arena, when they come, are also likely to be highly correlated among issuers. If a few communities stiff their creditors and get away with it, the chance that others will follow in their footsteps

will grow. What mayor or city council is going to choose pain to local citizens in the form of major tax increases over pain to a far-away bond insurer?

Insuring tax-exempts, therefore, has the look today of a dangerous business – one with similarities, in fact, to the insuring of natural catastrophes. In both cases, a string of loss-free years can be followed by a devastating experience that more than wipes out all earlier profits. We will try, therefore, to proceed carefully in this business, eschewing many classes of bonds that other monolines regularly embrace. ■

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© Warren Buffett is CEO and Chairman of the Board of Berkshire Hathaway. This article was excerpted from Mr. Buffett's most recent annual letter to Berkshire shareholders and is reprinted with permission.

## AICP Annual Conference

The Association of Insurance Compliance Professionals (AICP) will hold its 22nd Annual Conference October 4-7, 2009, at the JW Marriott Desert Ridge Resort in Phoenix, AZ.

This year's theme, “Rising to New Challenges,” represents the industry's response to the complex regulatory environment of the evolving insurance industry. Over 60 sessions will be presented.

Topics will include the special regulatory concerns arising out of mergers and acquisitions, bankruptcy, and privacy. Life and health-related sessions will include trends in healthcare, ERISA, and life insurance mandates.

General sessions planned include data reporting, market conduct, and tips for

successfully implementing compliance initiatives in economically challenging times. The program is designed to meet the needs of all levels, from novice to expert.

In addition, insurance commissioners from various states will discuss topical issues affecting their states and the industry at special “Commissioners Corner” sessions.

Events scheduled during the conference will provide networking opportunities with colleagues, speakers, regulators and exhibitors.

Conference registration will open in July. Visit [www.aicp.net](http://www.aicp.net) for regular conference updates and registration materials.



## IRES Chapter News

COLORADO — On March 16, **Steve Stick** of Chubb spoke about the costs and savings of building green and the different standards used in rating. Additionally, Mr. Stick spoke on underwriting issues associated with green buildings.

On April 2, **Don Koch** of NorthStarExams, discussed the use of a process review methodology in Market Conduct Examinations, which is a risk-based approach to market conduct exams.

— Tom Abel; Tom.Abel@dora.state.co.us

LOUISIANA — The Louisiana Chapter had its State Chapter Meeting on April 15. **Gwen Wilcox**, Assistant Director of the Senior Health Insurance Information Program (SHIIP),

presented “The Medicare Game Show.” Attendees were divided into three groups and questions were asked to test the participants’ Medicare IQ. In addition, membership was informed that nominations are open for new officers for the Chapter. Ballots will be sent to active members in May. There were 27 attendees at the meeting.

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

MICHIGAN — Welcome **Lynell Cauther**, MCM, new IRES State Chair. Lynell is the senior departmental analyst in the Market Conduct Unit, Office of Finance and Insurance Regulation.

— Lynell Cauther; cautherl@michigan.gov

### “ Quote of the Month ”

*It’s a template for the world. That’s not a boast, it’s recognition of where international standards are going, and hopefully others will build on that.*

— Peter Skinner, commenting on the enactment of a sweeping overhaul to the European Union’s insurance regulatory framework. A longtime member of the European Parliament, Mr. Skinner co-sponsored the bill. The new rules will take effect in 2012.

# Bay State Lessons for Health Insurance Reform

by Steve Tuckey

Three years after Massachusetts enacted near universal health care coverage, policymakers are looking to the state to see what lessons can be learned on the national level as the Obama administration attempts to at least start the process in Washington.

Two reports issued last month tell a conflicting tale of just which sector is finding its ox gored with an increased share of the costs of eliminating the uninsured.

Blue Cross Blue Shield of Massachusetts released the findings of a study that showed the overall distribution of spending on health insurance by employers, individuals and government remained essentially the same in 2005, one year prior to passage of the state reforms, and 2007, one year following.

Robert Seifert, a researcher from the University of Massachusetts Medical School, said the fact that no one group is contributing a greater share to coverage bodes well for the future success of the program. "This is important information to have as the state grapples with ways to sustain the law in the face of increasing health care costs," he said.

In 2007, employers and union health care plans accounted for slightly less than half of the total spending on health insurance in Massachusetts; the government accounted for about 30% and individuals about 25%.

Jarrett Barrios, president of the Blue Cross Blue Shield of Massachusetts Foundation which funded the report, said its findings were one measure of success for the reforms passed in 2006. "When this law was passed, there was a promise that employers, government and individuals would share the expenses of expanded access to care and that is what has happened."

But another report also issued in April put a slightly different slant on the topic of cost allotment. This report, issued by the state's Division of Health Care Finance and Policy, found the state cost of providing health coverage to state residents who work for large corporations and their families increased by 24.6% in 2008 over 2007 with the number of persons covered increasing 12%.

Wal-Mart had the highest number of employees receiving public health insurance coverage with 4,796, while the Commonwealth of Massachusetts placed third in that category.

Lindsey Tucker, policy manager at Health Care for All, said the question is not so much whether employers are doing their fair share for the employees they are covering, but rather whether they are doing their fair share for those the state is covering. The group supports legislation that would require employers to contribute more to a state fund that pays for subsidized health care coverage programs.

Business representatives not surprisingly took issue with such a measure. Associated Industries of Massachusetts CEO Richard Lord said that any tinkering with the law would undermine support employers have given to health care reform efforts over the years.

Coverage expansion and cost control have been the two sometimes competing goals of health care reform both nationally and in pioneering states such as Massachusetts.

According to a report in *The New York Times*, the GOP governor and Democratic legislature in 2006 put off any serious effort at cost control for the coverage expansion goal. The state's 2.6% uninsured now represents one-sixth the national average and the lowest such percentage for any state in the union.

## Controlling Costs

Last year the state imposed new taxes and fees in an attempt to shore up the plan's shaky finances, but it remains unclear how long that fix will last as the recession increases along with the number of new jobless residents. A high-level state commission is now looking at new methods to control costs which will focus on preventative care and quality of care, rather than quantity provided such as fee-based doctor visits. The panel expects to deliver its recommendations this spring.

Any serious attempt at cost control in 2006 would have aroused the opposition doctors, hospitals, insurers and consumers. The state has more doctors per capita than any other state and Boston is the home of a number of world-renowned medical and teaching facilities.

In an interview with *The Boston Globe* in January, Democratic Gov. Deval Patrick took aim at health insurers' increase in premium revenue over the years. "At some point you just have to say 'look, that is not acceptable, and more to the point, it is not sustainable.'"

Whether or not it was in response to such jawboning, insurers taking part in a state-subsidized insurance program, Commonwealth Care, submitted bids so low that premiums will be kept flat for 2010. In addition, the governor announced several weeks ago that \$222 million in federal stimulus funds would go toward supplementing the fund.

Meanwhile, the commission is said to be pondering cost-control measures as radical as doing away with the fee-for-service system and replacing it with reimbursement for episodes of care that would include bundling of payments to groups of providers who together would take responsibility for a patient's health care.

Will all this cost controlling lead to the inevitability of care rationing as many conservative critics contend? James Capretta, writing for the National Review blog, *The Corner*, said the Obama administration is pursuing the same strategy that Massachusetts pursued, which is to cover everyone at first and then worry about cost controls later. "It is obvious that the Obama

administration is hoping it can get a bill passed without endorsing the kinds of measures that would rightly be attacked as rationing care," he wrote.

On the left, Jason Rosenbaum, deputy director of online campaigns for the advocacy group Health Care for America Now, said Massachusetts deserved praise for increasing coverage for the uninsured, but did not go far enough in that it failed to create real competition with a public health insurance option. "As such, it is infeasible for national health care reform," he wrote.

Cambridge, Mass.-based Harvard Pilgrim CEO (and blogger) Charlie Baker says he isn't so sure Massachusetts should serve as a model for national reform. He writes that as a guarantee-issue state, with a declining population and relatively tight labor market, Massachusetts has several unique characteristics that could disqualify it from serving as a national template. As a guarantee-issue state, individual coverage is always accessible but expensive, which usually means any individual purchasing it plans on using it. Thus, when the state reforms merged the individual markets with the small group plans (50 or fewer members) the result was a 25% decrease for the former and 2% increase for the latter.

But with states that permit medically underwritten insurance, healthy people can gain individual coverage relatively inexpensively. Any national guarantee-issue effort, as recently agreed to in principle by the major health plans, would impact these people negatively. "This is exactly the opposite of what happened when reform was passed in Massachusetts, and needless to say, this would make those folks who have individual insurance now very unhappy," Baker wrote.

And while it could be argued that bringing the country into line with the Bay State's high standards might be a good thing, it may not translate into good politics. "Winners don't always notice the gain because it usually gets lost in the noise, but the losers almost always notice they have been hit with a huge increase, and they don't like it," he wrote. ■

# Regulatory Roundup

by  
Stroock & Stroock &  
Lavan LLP

## **Alabama — Bill restricting cancellation of homeowners' insurance passes Senate committee**

On March 23, the Alabama Senate Governmental Affairs Committee approved SB 434, a bill that would prohibit an insurer from cancelling or nonrenewing a homeowners' insurance policy on which no claim had been made during the preceding five years without specific justifiable cause. Justifiable causes include: (i) failure to pay premium; (ii) deception or fraud in obtaining or maintaining the policy; (iii) filing a false or inflated claim; (iv) failure to maintain the property in good repair; or (v) other reasonable grounds as provided by the Commissioner of Insurance. The Bill would become effective immediately upon passage. To view SB 434, visit the Alabama Legislature's Web site at [www.legislature.state.al.us](http://www.legislature.state.al.us).

## **Massachusetts — Appeals Court permits introduction of billed medical expenses**

The Massachusetts Appeals Court ruled, in a decision dated March 13, that a plaintiff is entitled to introduce certified medical bills into evidence to establish the amount of the plaintiff's damages even if the actual amount accepted as full payment by medical providers was lower than the billed amount. The case, *Law v. Griffith*, 73 Mass.App.Ct. 1127 (Mass.App.Ct.), concerned a plaintiff injured in an automobile accident, who brought an action seeking recovery for medical expenses and other damages.

The plaintiff sought to introduce certified medical bills as evidence of her medical expenses under G.L. c. 233, § 79G, which, among other things, requires that duly certified medical records "be admissible as

evidence of the fair and reasonable charge" for such medical services. The defendant moved to exclude the medical bills on the grounds that they were misleading since the amounts reflected in the invoices included charges that had been written off by the medical providers and for which the plaintiff was never obligated to pay (due to lower rates negotiated between the providers and plaintiff's insurer).

The lower court, in siding with the defendant, held that the statute was simply an exception to the hearsay rule and did not establish the relevance of medical charges to the plaintiff's damage. The Appeals Court reversed and held that, while one purpose of the G.L. c. 233, § 79G was to facilitate the introduction of medical bills and reports, "the statute also represents a Legislative determination that, apart from hearsay considerations, such records shall be admissible proof of the fair and reasonable charge for the services." The Court did note, however, that the defendant was not precluded from summoning the providers to trial and cross-examining them in order to establish that the fair and reasonable value of the services was other than as reflected in the medical bills. To view *Law v. Griffith*, visit the Massachusetts Appeals Court's Web site at [www.mass.gov/courts/appealscourt](http://www.mass.gov/courts/appealscourt).

## **New York — Insurance Department issues Circular Letter addressing "value-added" services offered by producers**

On March 3, the New York Insurance Department issued Circular Letter No. 9 (2009), providing guidance to licensed insurance producers concerning the kinds of services that may be provided to insureds or potential insureds without running afoul of anti-rebating and inducement provisions set forth in the New York Insurance Law, which generally prohibits the giving of anything of value (e.g., rebate of premium), or any service or incentive in conjunction with the sale of insurance that is not specified in the insurance policy.

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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.



In recognizing that the nature of services provided by insurance producers continues to evolve, the Circular Letter enumerates those services that would not violate anti-rebating and inducement prohibitions provided the services directly relate to the sale or servicing of insurance or provide information about insurance or risk reduction and are provided in a fair and nondiscriminatory manner.

These permissible services include: (i) risk assessments, including identifying sources of risk and developing strategies for eliminating or limiting risk; (ii) insurance consulting and advice; (iii) insurance-related regulatory and legislative updates; and (iv) certain claims assistance services (including preparation of claims forms).

The Circular Letter cautions, however, that because certain services are too attenuated to the provision of insurance, or would otherwise violate the law because they are not specified in the policy, the following services, if provided by an insurance producer to an insured or prospective insured for “free” or at a reduced fee, or otherwise offered in conjunction with insurance services, could, in the Department’s estimation, run afoul of the rebating and inducement provisions set forth in the Insurance Law.

These include services related to: (i) flexible spending administration; (ii) legal services; (iii) payroll, such as providing employers with check creation and distribution; (iv) referrals to third-party service providers through which an insured or prospective insured may receive a discounted rate while the producer is the producer of record; (v) advice regarding compliance with federal and state laws concerning human resource matters; (vi) management of employee benefit programs; and (vii) development of employee handbooks and training. To view Circular Letter No. 9, visit [www.ins.state.ny.us/circltr/2009/c109\\_09.htm](http://www.ins.state.ny.us/circltr/2009/c109_09.htm).

#### **Florida — Bill requiring annuity contract protections for seniors is introduced**

On March 19, SB 2520, a bill entitled the “Florida Senior Annuity Bill of Rights” was introduced in the Florida Senate. The Bill requires certain protections be incorporated into any annuity contract sold to an individual who, at the time of purchase, is a senior consumer (i.e., those 70 years or older). Under the Bill,

no such contract may be sold unless the maximum surrender charge period (i.e., the period before payments can be withdrawn without penalty) does not exceed nine years from the date of purchase and the maximum annual surrender charge for withdrawals made during the surrender charge period does not exceed 9% of the purchase payments.

Further, after the first contract year, senior consumers must be allowed free annual withdrawals in each contract year of up to 10% of the purchase payments for annuity contracts with a surrender charge period of seven years or longer. In addition, a senior consumer diagnosed with a terminal illness must be permitted to withdraw all purchase payments from an annuity contract prior to the expiration of the surrender charge period without penalty. If passed, the Bill would take effect January 1, 2010, applicable to annuity contracts issued or renewed on or after that date. To view SB 2520, visit the Florida Senate’s Web site at [www.flsenate.gov](http://www.flsenate.gov).

### **Voting begins for new members of 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.

The ballots are finalized. Look for one arriving soon in your mailbox. You may cast your votes now or assign your ballot to a proxy. You also may submit ballots and proxies at the annual IRES CDS in Baltimore this summer.

## Be Wary

In a TV interview shortly after last year's election, Rahm Emanuel, President Obama's Chief of Staff said, "You never want a serious crisis to go to waste." He went on to explain that a crisis often provides "an opportunity to do things you could not do before."

There are insurance executives who apparently think the same thing.

For them, the financial crisis offers an opportunity to push for federal regulation of the insurance industry despite the fact that under the state regulatory system, insurance companies did not abandon underwriting standards or sell risky credit default swaps. As a result, they have weathered the financial storm far better than their financial services counterparts.

Allstate's CEO Tom Wilson led the charge last month when he authored an op-ed piece in *The New York Times* urging a federal regulator for national insurance companies in light of the current crisis. He called for business leaders to work with the feds to create a new regulatory structure because state regulators "lack the expertise to properly oversee rapid innovation or systemic risks."

To buttress his point, Wilson said it "should come as no surprise that a big insurer like AIG would be a major issuer of credit default swaps." Well, that would be a surprise since AIG's non-insurance subsidiaries, regulated by the feds, were the firms that actually wrote those credit default swaps.

Wilson noted that although Allstate played a "small role" in the unregulated credit default market, responsibility for the crisis is borne primarily by "the insurance industry, regulators, banks and credit rating agencies." His basis for choosing to cite the insurance industry first among the culprits is anyone's guess.

Mr. Wilson's remarks enraged state regulators, particularly New York Superintendent Eric Dinallo. Dinallo responded first and forcefully. He directed Allstate to divulge its

participation in "unregulated insurance markets" and to report any insurers that illegally wrote such instruments.

The Washington-based Competitive Enterprise Institute (CEI) fired back claiming in a letter that Dinallo had opened his Allstate inquiry under false pretenses. The organization also charged New York Insurance Department employees with coercing insurers to back off from promoting federal regulation, but offered no evidence of such coercion. The reaction of many in the regulatory community to the CEI charges was: "Who the heck is the Competitive Enterprise Institute?"

Allstate responded to the New York inquiry by explaining that among its companies, only the Allstate Insurance Company and the Allstate Life Insurance Company had entered into credit default swaps and each company provided the necessary detail when they filed their Derivative Use Plans with regulators.

Meanwhile, the head lobbyist for the American Insurance Association, Leigh Ann Pusey, took a page out of the Rahm Emanuel book with her observation that the debate on new financial laws has "created an opportunity." She went on to say: "You can't really look at these concepts and ideas that are out there without looking at having a federal regulator for the insurance industry."

So, it appears that those who have long urged a federal role in insurance regulation have simply re-tuned their arguments to fit a new, post-crisis paradigm.

Be wary. There is no crisis so severe that someone will not seek to exploit it. It's still possible to look to the lessons of the current financial debacle and make appropriate changes to our regulatory system. With so many diversions, smoke screens and half-truths clogging the pathway to the truth, it won't be easy.

— W.C.



# BALTIMORE

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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

#### 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:  
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see IRES web site:  
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## BULLETIN BOARD

✓ Watch the mail for your IRES Board of Directors ballot!

✓ 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](mailto:mjhazen@ksinsurance.org) or **Rich Nebb** at [RNebb@ins.state.ny.us](mailto:RNebb@ins.state.ny.us).

### In the next REGULATOR:

*Baltimore CDS Preview*

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