

# The Regulator<sup>®</sup>

INSURANCE REGULATORY EXAMINERS SOCIETY

*States & Health Insurers Battle*

## What, exactly, is a Medical Loss Cost?

by Steve Tuckey

Special to *The Regulator*

**S**tate regulators will spend considerable time this summer looking at the question of exactly what health care expenses actually contribute to patient care and what are the mere obligations of running a business.

The National Association of Insurance Commissioners plans on sending a series of recommendations to the Department of Health and Human Services (HHS) as to categorization of such costs so that the Department can fulfill its mandate from the health care reform legislation signed into law earlier this year by President Obama.

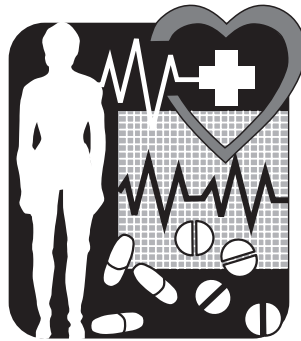
The law — The Patient Protection and Affordable Care Act — requires that insurers spend 80% of customers’ premiums on medical care in the individual insurance market and 85% in the employer group market.

Since these mandated medical loss ratios (MLRs) must be in place by 2011, regulators can expect plenty of advice from industry and consumer groups that fear categorizations that do not serve their interests.

NAIC president and West Virginia Commissioner Jane Cline knows how high the stakes are.

“The medical loss ratio and rebate program in PPACA have the potential to destabilize the marketplace and significantly limit consumer choices if the definitions and calculations are too restrictive,” she said in a letter to HHS Secretary Kathleen Sebelius, one of her predecessors in the top NAIC job.

“Equally,” she wrote, “the medical loss ratio and rebate program could be rendered useless if the definitions and calculations are too broad. Only through an open, deliberative process can we hope to reach a reasonable consensus that meets the dual objectives of protecting consumers and preserving competitive markets.”



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## P/C Insurers are *not* the Problem

by David A. Sampson

When we reflect on what’s happened in Washington the past couple of years, developments provide a powerful lesson in the old maxim, “don’t let the facts get in the way of a good story.”

As the efforts to reform the financial regulatory system worked their way through the usual Washington back-and-forth, those of us in the property/casualty insurance industry had to work hard to ensure that we were not unfairly identified as being part of the problem – and unfairly asked to shoulder the burden of making the economy whole if there is another financial meltdown.

Without question, we faced some serious challenges, and we experienced moments of great frustration and concern as to whether we would prevail. But in the end, the entire process has also presented us with a great opportunity: To assess how the insurance industry is perceived today and how it’s likely

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## From the President

### Closing Out a Landmark Year

It is hard to believe a year has passed since our last CDS meeting in Baltimore. It's been a year filled with issues, challenges and opportunities. Who would have predicted the extent of the U.S. and global economic meltdown? Add to that the



expansion of federal oversight into the business of insurance, landmark financial reform legislation, and, of course, the historic enactment of healthcare reform. It has been a busy, and at times overwhelming, 12 months!

I can assure you that dealing with hotel attrition penalties was not high on my agenda a year ago. Nevertheless, considerable time and energy was required to address the issue. My hope is that future boards and officers will not have to commit extensive amounts of time to this issue.

The Board has been busy this year in its usual monitoring of membership needs. In addition, some of the significant actions by the Board include:

- Adoption of a succession plan that sets down the process to ensure a smooth transition from one management firm to another due to normal business activity or unforeseen circumstances.
- Finalizing an IRES Conflict of Interest Policy.
- Acceptance of a financial review and recommendations.
- Completing a Request for Proposal for Management Services.

I would like to thank **David Chartrand, Susan Morrison, Elaine Bickel, Joy Moore and Scott Graham** for their help throughout the year. The combined efforts of each of you contribute to the successful operation of IRES on a day-to-day basis.

Permit me to also recognize the members of IRES' executive committee. Their efforts and assistance were very much appreciated. **Gary Kimball** has been an invaluable member dealing with budget

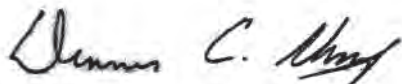
issues. His assistance on establishing this year's budget issues and his help in addressing attrition penalties was enormous. **Anne Marie Narcini** and her committee developed a designation program focusing on consumer complaint handling. This is an untapped area that holds potential for considerable growth in our organization. **Jo LeDuc** provided a historical perspective and a wealth of IT knowledge. Many thanks, Jo, for your willingness to offer suggestions or simply being available to discuss items.

**Tom Ballard** was very instrumental in scheduling future CDS locations, the development of the succession plan and dealing with attrition issues. **Mark Hooker** and his CDS team are producing another great program featuring timely issues of interest to all attendees. While this is Mark's first year on the committee he has been a source of energy and always willing to become involved in issues.

**Leslie Krier** and her membership committee continue in their efforts to identify and offer additional value to IRES members. Leslie will be the incoming President of IRES. I've been fortunate enough to work with Leslie on market regulation issues over the past few years. She knows the insurance marketplace and is keenly aware of regulatory options available to departments. I have no doubt Leslie will do an outstanding job as IRES president.

Finally, I would like to recognize the efforts of **Wayne Cotter** in his role as editor of *The Regulator*. With respect to the president's column, he was always there for me with suggested topics for consideration and timely deadline reminders.

Look forward to seeing you in Albuquerque.



Dennis C. Shoop, MCM  
IRES President

## “ Quote ” of the Month

*We were pleased to see that the Federal Insurance Office set up under the bill is narrowly designed to carry out its mission while not unnecessarily undermining strong state regulation.*

— Jane Cline, NAIC president and West Virginia insurance commissioner, commenting on the Federal Insurance Office provisions of the financial reform bill, H.R. 4173, passed by the U.S. House of Representatives.

## Welcome, new IRES Members!

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# The Emerging Need for IT Examiners

by Tim Nauheimer

**A**s insurers have increased their reliance on information technology (IT), the need for sound automated controls has emerged as a key component in a company's overall internal control environment. The recent surge in the number of insurers offering products online and online claims capability are examples of automated systems that rely upon an IT structure to support them. Increased reliance upon IT highlights the need for a strong IT control environment.

IT governance is the responsibility of senior management and the board of directors. Such governance consists of the leadership, organizational structures and processes that ensure that the enterprise's IT sustains and extends the organization's strategies and objectives. Although having a strong IT internal control environment is the responsibility of a company's management, insurance examiners must be in a position to assess IT risks and controls to conduct a thorough examination, hence the need for IT examiners.

IT risks and controls should be assessed in accordance with the risk-focused methodology set forth in the NAIC's Financial Condition Examiners Handbook. IT risks not only exist on the financial condition side, but are just as important on the market conduct side. However, to fully understand IT risks and controls, a specialized skill set is necessary. Most states only have a handful of IT examiners with the specialized skills necessary to conduct the IT portion of the exam.

## Certifications

The IT auditing profession has grown in stature over the years as evidenced by the professional designation certifications that are now available. The most widely recognized certifications for the IT examiner are the Certified Information Systems Auditor (CISA) and the Automated Examiner Specialist (AES). These certifications typically require the candidate to pass an exam, have a number of years of experience and maintain continuing education requirements. Since they already have the practical experience, financial examiners could become proficient IT examiners by obtaining one or more of these designations.

## IT Examiner Job Function

The IT Examiner is typically expected to perform the following functions on an examination:

- Provide Information Technology (IT) examination services in accordance with audit standards, guidelines, and best practices to determine if the organization is ensuring that its information technology and business systems are protected and controlled. IT examiners should be familiar with the Control Objectives for Information and related Technology (COBIT) governance and control framework.
- Evaluate whether the organization has the structure, policies, accountability, mechanisms, and monitoring practices in place to achieve the requirements of corporate governance of Information Technology.
- Assess the systems supporting operations (i.e., systems for claims, investment activities and other insurance functions) and the related management information systems from which reports relied upon by management are generated.
- Discuss IT examination findings with supervisory staff and participate in meetings with other Department and institutional staff.
- Supervise staff assigned to examinations by: developing the IT examination plan; organizing and coordinating activities during the examination; assigning work; monitoring staff progress in accomplishing assignments; providing guidance and assistance to staff; evaluating staff performance; and reviewing examination findings.
- Prepare the written IT portion of the overall examination report.
- Participate with representatives of other state agencies in performing joint or concurrent IT examinations.
- Conduct and participate in training of Department staff on IT examination issues.

## COBIT

COBIT is the generally accepted internal control framework for IT. COBIT is a framework and supporting tool set that allows managers to bridge the gap with respect to control requirements, technical

issues and business risks, and communicate that level of control to stakeholders. COBIT enables the development of clear policies and good practices for IT control throughout enterprises. Many insurers have adopted a COBIT framework or at least its major components.

### **IT Examiner Role**

The role of the IT examiner has emerged as a critical component of the risk-focused examination. As companies' reliance on IT has significantly increased over the years, so has the involvement of the IT examination function. Virtually every significant process of an insurer includes some automated component. Even the smallest companies use some form of automation.

Numerous initiatives are continuously evolving to refine the exam process. A recently revised Exhibit C in the Financial Condition Examiners Handbook contains specific procedures and guidance for the IT portion of the exam. Key systems identified by the financial examiner should also be assessed by the IT Examiner. Additionally, IT examiners should conduct their own risk and control assessment of a company's key systems. The increased reliance on automated systems by insurers underscores the need for both financial examiners and IT examiners to focus on automated risks and controls.

### **NAIC**

The IT Examination Working Group of the NAIC is the primary working group that updates guidance in the Financial Condition Examiners Handbook related to the IT reviews that should be performed in conjunction with financial condition examinations.

One of the charges of the working group is to monitor state usage of automated examination tools, technology changes, and emerging issues, in order to reevaluate examination processes and keep states abreast of the latest tools, techniques, and training.

Other charges include a review and revision, as needed, of the "General Information Technology Review" and "Exhibit C-Evaluation of Controls in Information Technology" sections of the Financial Condition Examiners Handbook. Recently, the IT examination working group revised these two sections of the Handbook to a more risk-focused approach.

The revised IT review approach is meant to be a new standard for conducting IT reviews and Exhibit C is meant to be used as a tool to conduct these reviews. In addition, the working group offers online IT training

courses and plans to revise the accreditation standards for state insurance departments.

### **A Personal Perspective**

Personally, I have always thought the role of the IT examiner was an exciting one. In fact, I seriously considered crossing over from being a financial auditor many years ago. Since IT examiner resources were scarce even back then, I had to perform many of the audit steps typically performed by IT examiners anyway. I invariably would uncover issues involving user access and entitlements.

I frequently found that terminated or transferred employees still had active user IDs and passwords. And almost always, employees had inappropriate access to systems based on their job functions.

Of particular interest to me was conducting a review of the physical security of the server room (i.e., the room that houses multiple IT servers). The review usually included an attempt to "break-in" or gain access to the server room, and many times our team was successful. Often the ceiling tiles over the entry door or interior walls could be easily lifted and one could climb over and into the server room. These audit steps were a fresh break from the typical financial audit steps.

Another cool task was the attack and penetration exercise. This is where true IT expertise is needed. An attack and penetration review entails trying to hack into the company's systems both from within and outside the company. More often than not our teams were able to hack in from inside the company. The outside attempts, however, were less successful.

Many people do not realize the multivariate tasks that auditors and examiners perform — they are *not* just number crunchers or computer geeks. So if you're currently conducting IT examinations or believe this is a field you would like to enter, I encourage you to do everything you can to raise your level of expertise. Also look into gaining a professional designation in this growing field. Insurance departments definitely need talented people capable of performing IT exams. For many, conducting an IT exam offers a refreshing alternative to engaging in your typical financial or market conduct examination. ■

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**Tim Nauheimer is Chief Risk Management Specialist with the New York State Insurance Department.**



# Medical Loss Costs

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Fears that the new MLR requirements could drive some insurers out of the market have recently surfaced among regulators. They are considering recommending a gradual three-year transition in states where the new requirement could destabilize the market, according to a report in *The New York Times*.

## NAIC Recommendations

NAIC spokeswoman Vanessa Sink said the report stemmed from discussions in the Accident and Health Working Group Actuarial Subgroup and findings could become a part of the final NAIC recommendations, but not before a long series of approvals are obtained.

The *Times* article quoted a subcommittee document as stating that “without a transition insurers may cancel individual policies, if the terms of the policies permit cancellation and cease offering these plans.”

“This potential withdrawal could have a severe impact on the currently insured, who would lose their policies, and could also limit the choices available to prospective purchasers,” the document noted.

The new law gives Sebelius the power to transition any new MLR requirements over several years. But having the NAIC bless such a plan would make it more palatable in all likelihood.

The *Times* said eight million individual policyholders are covered by 400 insurers. Nearly half of those policyholders are covered by 70 insurers whose loss ratios were less than 75 percent in 2009.

The American Academy of Actuaries also expressed concern that the 80-85 rule could disrupt the market. Some carriers, the group fears, may seek to exit the market to avoid the potential impact on solvency the rule may have, another *Times* story reported.

Such concerns have not deterred consumer groups that have expressed fears that health care insurance

companies will take special pains to label all sorts of administrative expenses as contributing to patient care.

## WellPoint

Carmen Balber, Washington Director for Consumer Watchdog, said that before any insurer reclassifies costs as “medical care,” insurers must provide credible scientific evidence that the function improves the health care status of individual policyholders. She cited the recent reports of what she termed “wholesale reclassifications” by WellPoint as something to guard against.

“Any program or function added under the new ‘health quality’ definition must be stringently monitored by the Department of Health and Human

Services to protect against future abuses,” she said.

WellPoint has become something of a flash point in the MLR debate in the aftermath of its withdrawal in May of a proposed 39% rate increase in California. That action led Sebelius to urge states

“Fears that the new medical loss ratio requirements could drive some insurers out of the market have recently surfaced among regulators.”

to carefully review all of WellPoint’s rate increase proposals for errors and even led to some calls for the federal government to become a national rate regulator.

In a Senate Commerce Committee report, Sen. Jay Rockefeller, (D-WV) took a dim view of the giant insurer’s recent reclassification of more than \$500 million worth of expenses from administrative to the patient care category.

## Defining the Numerator

Wendell Potter, a former top CIGNA public relations official who now works with the Center for Media and Democracy, also cited disease management programs as items that could be up for grabs as to classification as administrative or health care expenses. “Many of them are good and some have been verified as to be valuable to patients,” he said.

Only programs that can be verified as improving patient care should be included in what Potter termed

## Medical Loss Costs

“the numerator.” He said, “The problem is insurers can call any kind of program a disease management program and shift the cost of that program over to the numerator.”

Utilization review programs could also fall into this questionable category in that they often are used to deny physician-recommended treatments. “Likewise quality assurance programs and provider credentialing activities are administrative functions that insurers have not considered direct medical expenses in the past and should not be allowed to be classified as such now,” said a group of consumer representatives in a letter to the NAIC.

### “Safe Harbor” List

Joan Gardner, executive director, state services, for the Blue Cross Blue Shields Plans of America, said that a “safe harbor” list of activities should be included for the 80 and 85 categories, including member health improvement activities such as consumer education materials, nurse call lines, case management and activities to combat fraud and abuse.

“By properly aligning incentives — through disease management and care coordination, pay for quality initiatives, prescription drug adherence programs, etc. — health plans can help drive quality improvements and transform care delivery to improve care for customers,” Gardner told the regulators.

Aetna asserted that the cost of external appeals

should be considered in the patient care category along with costs for “arranging favorable provider reimbursement rates.” Assurant Health said evaluation costs for proper medical code billing and making information available about the cost and quality of individual providers should also be included.

If insurers begin classifying claims expenses as expenses related to health care, then consumers will receive a negative benefit from the law. “Insurers will so easily surpass the 80 percent and 85 percent minimums that they will actually have more premium dollars to spend on administration, executive salaries and profit, and the legal right to demand that policyholders pay the bill,” Balber said.

Health information technology costs remain another area of contention, particularly in light of the Obama Administration’s push to digitize medical records. “There are some information technology expenses that should be included in the numerator [patient care expense]

but not all because a lot of spending insurers do in this area has nothing to do with improving quality of care,” Potter said.

For example, he said, programs aimed at curbing medical errors could fall into the patient care category while spending on improving claims systems might fall in the administrative category. ■

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

“If insurers begin classifying claims expenses as expenses related to health care, then consumers will receive a negative benefit from the law.”

What’s happening in New Orleans this Summer?

*See page 16.*

Don’t wait to book a room for the Albuquerque

CDS. *See page 19.*

# *P/C Insurers not the problem*

*continued from page 1*

to be perceived in the future. And for consumers and lawmakers alike — that question begins with how the industry is regulated.

First, however, it might be useful to think about the misperceptions that existed, the ones we had to fight hard to change. None was more threatening to our profession than the idea that, somehow, we had a role to play in the nation's financial collapse.

Readers of *The Regulator* know that this isn't true. The crisis happened primarily because banks and investment firms made risky bets on subprime mortgage pools and other investments. Experts concluded that a combination of lax oversight, and an ever-expanding housing bubble created a "perfect storm" for the worst financial crisis since the Great Depression.

It took no small amount of hard work for the Property Casualty Insurers Association of America (PCI) to convince lawmakers that lumping property/casualty insurers in with financial services institutions was the wrong approach. Casting the net too wide would not only be unfair to home, auto and business owners who rely on property/casualty insurance but would also create a host of unintended consequences, many of which would work against the aim of financial services regulatory reform: A desire to prevent such a crisis from happening again.

We worked hard to help policymakers in Washington understand that the property/casualty insurance industry was far from the tables at which these risky bets were made.

The fact of the matter is, we're already effectively regulated at the state level and, in order to honor thousands of claims at a time after hurricanes and other natural disasters, we're restricted to making only highly-liquid and conservative investments — the better to keep our cash close at hand.

But of course, you know this and I know this.

And together we were able to build the case. The first step was a 2009 Treasury Department white paper that looked into the root causes of the financial meltdown and concluded that "the current crisis did not stem from widespread problems in the insurance industry."

Furthermore, the investment firm MSCI Barra took a look at 35 different industries in 2008 — just as the economic collapse was beginning — to try and determine which industries were the most leveraged. Its conclusion: The insurance industry ranked 27<sup>th</sup>, or near the bottom, safer even than low-leverage industries like those that make household products. By contrast, financial services firms like those that helped cause the near-collapse of Wall Street ranked 7<sup>th</sup>.

So here is the point we had to clarify with lawmakers and the media: The property/casualty insurance industry is strong and stable, and provides peace of mind to millions of policyholders nationwide

who want swift and speedy action when they have to file claims related to their homes, automobiles or their businesses, and that the industry had nothing to do with the current financial crisis.

In the end, this is a good place from which to start when we think about how the industry might be perceived in the future.

Simply put, the property/casualty industry has been tested like never before over the past ten years, and the story we have to tell is one of an industry that's passed with flying colors when it comes to helping homeowners and property owners cope with the devastating effects of a natural disaster.

Our record makes clear that when people think of home, auto and business insurance, they should think of an industry that's on their side, providing the peace of mind that comes through knowing for sure that even if the unthinkable happens, their insurance company is backing them every step of the way.

Why do I think this can — and should — be the

“ *The property/casualty industry has been tested like never before over the past ten years.* ”



## P/C Insurers not the Problem

way Americans think of the insurance industry?  
Consider these facts:

- According to the Insurance Information Institute, insurers paid more than \$41 billion in claims following Hurricane Katrina.
- The Insurance Information Institute conducted a study a year after Hurricane Katrina and found that 95% of the one million homeowners' insurance claims in Louisiana and Mississippi resulting from Katrina had been settled.
- This might be why a poll taken in 2006 of Gulf Coast Katrina victims by IPSOS Public Affairs found that 89% of homeowners in Louisiana and 93% in Mississippi were satisfied with the way their insurance company handled their claims.

The industry's handling of Katrina claims was hardly an aberration. Hurricanes account for just under half of all disaster claims, with a history of striking the Gulf Coast and the Atlantic Seaboard. They ravage some of our nation's most populous regions.

In 2004, there were about two million hurricane-related damage claims, valued at \$22.9 billion; more than 95% of were settled in four months or less.

And while property and casualty insurers move quickly to settle claims, policyholders also can rest assured that their insurance company is with them for the long haul, and is unlikely to be buffeted by financial storms. Reflecting again for a moment on the current fiscal crisis, it's worth noting that not a single property/casualty insurer was declared insolvent in 2008.

What's more, the more than 1,000 companies that make up the PCI all pay into state guaranty funds – meaning that in the extremely unlikely event of a property/casualty insolvency, there's a guaranty fund that ensures that policyholder claims will be paid.

Which simply frees us to do what we do best — serve our customers. ■

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David A. Sampson is President and CEO of the Property Casualty Insurers Association of America.



## Vaughan: Regulators Acted as “Cohesive Unit” in AIG Crisis

Insurance regulators acted as a cohesive unit during the AIG crisis in September of 2008, said Therese Vaughan, chief executive officer of the National Association of Insurance Commissioners.

Vaughan made the remarks at a session at the Standard & Poor's annual insurance conference last month in New York.

“New York led the effort in dealing with the Federal Reserve during the AIG crisis,” Vaughan said. “The problem was that the Federal Reserve was not familiar with the state regulatory system.”

Vaughan also said that state insurance regulation for the most part has focused on the legal entity up until the 2008 crisis, but in its aftermath must do a better job of looking at the risks of the entire holding company.

“You can't ignore the legal entity, but we have to do a better job of opening up the windows,” she said.

Vaughan said the Troubled Asset Relief Program (TARP) legislation actually permitted granting funds to life insurers and the initial decision to reject the effort was purely political. But she said that the fact that so few companies looked to the federal government for relief at the time was a good thing.

The former Iowa commissioner also said that while insurance regulation remained state-based, it was truly national in that its accreditation process provides national solvency standards and its peer review process promotes uniformity among regulators.

Vaughan also noted that the US insurance regulatory system received kudos from a recent review by the International Monetary Fund (IMF). “They [IMF] said there is no regulatory system in the world that is doing what we are doing today.”

— Steve Tuckey

## Little Known Albuquerque Facts

- Notah Begay III, the first full-blooded American Indian PGA golfer, was born and raised in Albuquerque.
- Jeff Bezos, founder, president, chairman and CEO of Amazon.com was born in Albuquerque.
- Neil Patrick Harris, who plays the sleazy Barney Stinson in *How I Met Your Mother* but also played the lovable Doogie in *Doogie Howser, M.D.* is a proud Albuquerque native.
- Mike Judge, creator of the television show *King of the Hill* and writer and director of the movie *Office Space*, was raised in Albuquerque.
- Actor Freddie Prinze, Jr. was raised in Albuquerque.
- The house of beloved World War II correspondent Ernie Pyle is now a branch of the Albuquerque Public Library and offers a display of his personal memorabilia.
- The Shins, a Grammy-nominated indie rock group, was originally based out of Albuquerque.
- Al Unser Sr., Al Unser Jr. and Bobby Unser, repeat winners of the Indianapolis 500, were all born in Albuquerque. The Unser Racing Museum in Albuquerque highlights family accomplishments and auto racing.

Source: [www.itsatrip.org](http://www.itsatrip.org)

Our favorite Albuquerque quote comes from Bugs Bunny who, on numerous occasions, would emerge from his rabbit hole, look around at some exotic location (such as a Mexican bullring), and say:

*"I knew I shoulda taken that left turn at Albuquerque!"*

See more CDS-related stories, pages 12-14



ALBUQUERQUE

## California's Proposition 17: Harvey Won

In the May 2010 issue of *The Regulator*, author Brian Sullivan regaled us with the behind-the-scenes story of California's Proposition 17 (*"The Most Excellent Adventure of Harvey & Mr. Joseph"*). In case you missed the piece, Proposition 17 was a June 8 California ballot initiative that would have permitted auto insurers to offer new customers discounts for maintaining continuous insurance coverage with a competitive carrier.

Such discounts would be similar to the "persistence" discounts that permit insurers to lower premiums for customers who maintain coverage with their current carriers over an extended period of time.

The major impetus behind Proposition 17 was George Joseph, Chairman of Mercury Insurance and known to California's insurance community as Mr. Joseph. In opposition was longtime consumer advocate Harvey Rosenfeld (a.k.a. Harvey) who helped usher in California's current auto insurance regulatory environment via Proposition 103, the landmark 1988 ballot initiative. Harvey is founder of Consumer Watchdog.

California auto insurance statutes, which are rooted in Proposition 103, do not allow auto insurers to base rates for new customers on whether or not that customer has consistently maintained insurance coverage with a competitor. The prohibition was put into place to avoid premium increases for those whose coverage was disrupted for reasons beyond their control. For example, a person who temporarily moves out of state or is without an automobile for a period of time would not in all likelihood qualify for a discount under such a rule.

Mr. Joseph, on the other hand, believes such a law is pro-consumer because it would allow smaller insurers to compete with bigger competitors. Ultimately, he believes the consumer wins because persistence

discounts would now be available not only from one's own insurer but from dozens of competitors as well. Mr. Joseph and Mercury Insurance spent millions to convince California voters to support the measure.

In case you hadn't heard, Harvey and Consumer Watchdog won. The measure was defeated 52% vs. 48%.

Naomi Seligman, Consumer Watchdog's Director of Public Affairs, described the battle as a "David v. Goliath" effort. "Mercury," she said, "put \$16.9 million into the campaign. We spent a fraction of that."

So how was Consumer Watchdog able to defeat Goliath? "Californians," said Seligman, "recognized that Mercury had a number of problems . . . and realized under

Proposition 17 some of them would be paying a lot more for coverage."

Seligman stressed that most insurers did not support Mercury's position on this issue. "Mercury did this for Mercury," she said. "In fact, USAA came out strongly against it because they saw how it would discriminate against their military customers."

Will this initiative mark the end of Mercury's campaign? Seligman's not sure. "They've gone through the courts, they've gone through the legislature, they've gone through a referendum," she said. "It's possible Joseph will try to go further, but if he does we're here to jump in and protect consumers."

A call to Mercury Insurance for comment was not returned. ■

*It's possible Joseph will try to go further, but if he does we're here to jump in and protect consumers.*

— Naomi Seligman, Consumer Watchdog

### IRES "MCM" Programs 2010

Seattle, WA — August 18-20

Dallas, TX — October 6-8

Warwick, RI — November 8-10

Check [www.go-ires.org](http://www.go-ires.org) for details.

# Financial Reform Bill: Insurers Do Not Pose Systemic Risk

by *Steve Tuckey*

**I**nsurance industry advocates for a relatively weaker federal insurance presence appear to have won the day as Senate and House lawmakers reached final agreement on a financial regulatory omnibus bill that was expected at press time to be signed into law by President Obama.

Overall, the insurance industry met most of its objectives in the Dodd-Frank bill in that carriers will not fall into that group of companies the bill singles out as posing a systemic risk to the nation's economy in the event of failure.

But on the one issue that divided the industry in deliberations over the past year, the new Federal Insurance Office (FIO) does not incorporate the preemption powers over state regulation that groups such as the American Insurance Association and American Council of Life Insurers favored.

The National Association of Insurance Commissioners last month expressed general support for the bill as it was taking shape.

David Sampson, president of the Property Casualty Insurers Association of America took special pains to point out "the conference report also now includes important federal insurance office provisions for appropriate due process to address questions over federal preemption."

"FIO determinations will be subject to de novo judicial review," he said.

Sampson also noted that "essential new provisions were added to help reduce duplicative information gathering requests on insurers," namely the Office must first request the data from state regulators before seeking such data from the carriers themselves.

But Sampson expressed concern that "duplicative federal oversight threatens to add costs to the insurance marketplace without corresponding benefits to consumers."

"It also creates potential conflicts with existing state regulatory protections," he said.

Both the American Insurance Association (AIA) and American Council of Life Insurers (ACLI) issued general statements of support for the new FIO.

By avoiding the systemically risky categorization, insurers will not be subject to a new pre-event funding pool that would supplant the state-based guaranty system. "Home, auto and business insurers have been strong and stable throughout the financial crisis and are not systemically risky," Sampson said.

Leigh Ann Pusey, president and CEO of the AIA, said "the existing state-based resolution mechanism remains in place and policyholders remain protected by the state guaranty fund system."

Frank Keating, president of the ACLI, expressed concern that "the final legislation reflects a bank-centered approach to regulation that does not always mesh with the life insurance industry, our existing regulatory structure and the way we address consumer needs."

Keating said the bill leaves several questions that will remain unanswered until the formal rule-making process is complete.

Life insurers had expressed concern that new derivatives restrictions would impair their use of certain derivative instruments that they believe provide policyholder protection through their hedging capabilities. The legislation leaves the Securities and Exchange Commission along with the Commodity Futures Trading Commission as the final arbiters of their concerns.

"ACLI is confident that we can make a strong case to the SEC and CFTC [Commodity Futures Trading Commission] on how life insurers use derivatives to reduce risk and why we should be excluded from the definitions of 'swap participant' and 'major swap participant,'" Keating said. ■

# Come to Albuquerque: You'll be Glad You Did!

by *Steve Martuscello*

The 2010 IRES Career Development Seminar (CDS) is rapidly approaching. On behalf of **Mark Hooker**, the Education Committee Chairperson, **Joe Bieniek**, Vice-Chair, and **Wanda LaPrath**, my CDS Co-Chair, I would like to extend an invitation to attend and participate in a meaningful, educational experience designed for insurance regulatory professionals.

From a personal standpoint, as of August 2010, I will be starting my 41<sup>st</sup> year of working for the New York State Insurance Department. More than half those years have been devoted to the IRES organization. Without a doubt, IRES has made me a better and more productive employee.

As I reflect upon my career, I think about people and experiences that have helped shape my working life. High on that list is my involvement in IRES and my attendance at the annual CDS. Even after all these years, I still look forward to attending. I always learn something new and try to use that knowledge to improve my job performance. Yes, after more than 40 years on the job, I'm still learning!

The truth is learning never stops. With this in mind, we have once again looked for ways to improve the CDS and improve the learning experience for IRES members. We believe this year's seminar will meet or exceed your expectations.

The CDS begins with a Welcome Reception Sunday night. It's a nice way to relax after a day of travel.

On Monday, we will start with our conferment ceremony honoring individuals who obtained their AIE, CIE and MCM designations. Their achievements truly reflect the primary purpose of IRES, which is to educate our members.

In keeping with IRES tradition, **Jane Cline**, NAIC President and West Virginia Insurance Commissioner, will deliver our Monday keynote address.

In recognition of the enactment of the historic federal health insurance legislation, our General Session on Monday covers health care reform. This session will be moderated by **Terri Vaughan** of the NAIC

and will feature leading government and industry experts. We think the panel discussion will help you better understand the roles of the states, the federal government, and the insurance industry in this new frontier.

The opening General Session on Tuesday will be the Commissioner's Roundtable. Again, we are fortunate to have three outstanding participants: **Susan Voss**, Iowa Insurance Commissioner; **Jane Cline**, West Virginia

Commissioner and NAIC President; and **Terri Vaughan**, NAIC Chief Executive Officer. Questions are encouraged and appreciated — make sure you leave yours at a special drop box located at our registration desk.

One thing IRES prides itself on is our breakout sessions. They are diverse, informative and interactive.

This year, we have expanded the Information Technology (IT) Section breakout sessions. We will have two IT sessions, with one devoted specifically to ACL Services Ltd (ACL) and TeamMate auditing software tools.

Our other sections also offer topics that will pique your interest. Some examples include:

**A Facelift for Market Regulation?** – How has accreditation impacted market regulation and what can we expect in the future?

**Annuity Academy** – This session offers basic training on the NAIC annuity suitability and disclosure models, and looks at the trends for indexed products.

**Fraud and the Economy: Unwelcome Partners** – A fraud specialist will examine the correlation between economic downturns and fraudulent activities, and the impact this has on the insurance industry and consumers.

The above represents just a small taste of the educational opportunities that await you in Albuquerque. And remember, attendance at the CDS allows you to earn up to 15 continuing education credit hours.

If you have not already done so, please register now. You'll be glad you did. ■

**Steve Martuscello, CIE**, is an IRES past president

CDS 2010  
Albuquerque

## Albuquerque & the Land of Enchantment

by Wanda LaPrath, Marta Barela, and Darla Brewer

**T**he IRES CDS is quickly approaching. We hope you have registered by now and have placed the dates of August 29-31 on your calendar. Albuquerque, this year's site, offers something for everyone.

Albuquerque is home to the longest aerial tram in the world. This offers a great opportunity to soar over the cliffs and arrive at the top of Sandia Peak. From there you can view the whole valley in which Albuquerque lies. After a fairly short walk, you'll find a spectacular view of Santa Fe and points to the north and east. If you prefer a longer walk, hiking at the top or bottom is available. You can also enjoy a bite to eat at the top (along with the spectacular view) or at the bottom.

There are several museums in the area, including the National Atomic Museum, the Albuquerque Museum of Art & History, and the International

Balloon Museum. There are two museums at the Indian Pueblo Cultural Center, which also features traditional dance performances every weekend and shopping opportunities for native arts and crafts. Albuquerque also offers the Explora/Albuquerque Biological Park which features a zoo, botanical gardens, and an aquarium.

Would you like to explore historical sites? Our CDS will be held just blocks from Route 66 which runs through Albuquerque. There is also

Old Town with the almost 300-year-old San Felipe de Neri Church, great restaurants, and shopping opportunities.

Albuquerque is also a great entry way to New Mexico (i.e., the Land of Enchantment) and neighboring states.

Santa Fe, with its history and culture, is approximately an hour away and may be reached by the Rail Runner train. Santa Fe offers an abundance of museums – The Children's Museum, the Georgia O'Keefe Museum, and the Museum of Indian Arts and Culture — to name a few.

The Cumbres-Toltec Scenic Railroad, headquartered in Chama (a three-hour drive from Albuquerque), features 64 miles of track between Chama, New Mexico and Antonito, Colorado. The scenery along this route is breathtaking.

There are several national parks and monuments within a six-hour drive including the Petroglyph National Monument, Petrified Forest, the Great Sand Dunes, and Mesa Verde National Park.

There are also great opportunities to explore the cultures of the Land of Enchantment. In addition to the Indian Pueblo Cultural Center



San Felipe de Neri Church with Luminarias

photo courtesy of newmexicostock.com

and the ruins at national parks/monuments, there are 19 pueblos, including the Zuni and Acoma, the Jicarilla Apache Nation, the Mescalero Apache Reservation and the Navajo Nation.

For baseball fans, the Los Angeles Dodgers' Triple A team, the Albuquerque Isotopes (no, we aren't kidding) will be at home from August 21 – September 2.

Interested in the foods of New Mexico? There is a great variety of restaurants in the area. You can find very spicy dishes, such as *carne adovada*, as well as milder dishes. There are also places to find Indian fry bread as well as great enchiladas, tamales, and the more traditional American dishes. A New Mexican meal definitely has a flavor all its own, and you can choose among three colorful chili dishes: green, red and Christmas.

Albuquerque also offers you an opportunity to enjoy the night life. There are several Indian casinos in the area. Two are stops on the Rail Runner, which also has a stop near the CDS hotel. Sandia Resort and Casino, Tamaya Resort & Spa, and Buffalo Thunder Resort also offer nationally ranked golf courses.

Some additional activities to consider:

1. Hiking at Tent Rocks at Cochiti Pueblo.
2. Ride the train to Santa Fe, go to the Plaza and shops, eat at one of the many restaurants such as the Shed, Maria's, or Tomasitas.
3. The Santa Fe Opera House offers several productions in late August along with a concert featuring Ray LaMontagne and David Gray on Tuesday, August 31.
4. Visit Madrid, an old mining town on the Turquoise Trail, with its shops and restaurants.
5. Visit the annual Indian Market which this year will open on August 20 and 21 (also available via the Rail Runner).



photo courtesy of Ron Behrmann

Hot Air Balloons over the Rio Grande

6. Go to the Nature Preserve in Albuquerque on Candelaria to do some bird watching while walking along the Rio Grande River.

There are many more opportunities in the Land of Enchantment and surrounding states which offer you the opportunity to enjoy and learn about the Southwest. Go to [www.newmexico.org](http://www.newmexico.org) for even more ideas. Also check out the IRES Web site and past issues of *The Regulator* for additional ideas.

See you in Albuquerque and the Land of Enchantment! ■

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The authors all live in New Mexico. Marta Barela is New Mexico's IRES State Chair and Wanda LaPrath is this year's CDS co-chair.



Dancers at Pueblo Indian Cultural Center

photo courtesy of MarbleStreetStudio.com



# IRES Chapter News

**LOUISIANA** — The Louisiana Chapter held a State Chapter Meeting on April 20. The speakers were **Audrey Higginbotham**, Insurance Specialist 3 – Louisiana Department of Insurance, Office of Property & Casualty, Policy Forms Division; **Joe Sloan**, CFM, Lead Insurance Specialist of FEMA; and **Keith Lutz**, CPA, Louisiana Department of Insurance, Office of Financial Solvency, Financial Analyst. The meeting was divided into three one-hour sessions.

In the first session, Ms. Higginbotham delivered a PowerPoint Presentation entitled “Hurricane Preparedness” and stressed the importance of consumers knowing what their homeowners policy covers and what it excludes. She also discussed Coverage A – Dwelling, Coverage B – Other Structures, Coverage C – Personal Property, Coverage D – Loss of Use, exclusions, filing a claim and hurricane deductibles.

Mr. Sloan then presented an overview of the National Flood Insurance Program (NFIP). He discussed the Flood Insurance

Rate Map and the Write Your Own Policies Program. The Program allows participating p/c insurers to write and service the Standard Flood Insurance Policy in their own names. The companies receive an expense allowance for policies written and claims processed while the federal government retains responsibility for underwriting losses.

According to Mr. Sloan, 21,000 communities participate in the NFIP with 5.5 million policies. In December 2009, he said, there were 484,000 policies covering Louisiana residents. He distributed two brochures: “Top Ten Facts for Consumers” and “Myths and Facts about the National Flood Insurance Program.”

In the final session, Mr. Lutz’s offered a PowerPoint Presentation called “A Personal Journey.” Mr. Lutz’s home was severely damaged by Hurricane Gustav. His presentation included a personal account of what happened the day Gustav hit, the rebuilding process, and how his family endured during the ordeal.

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

## In Louisiana: Three separate & exciting events!

- **SERA** — Southeastern Regulators Association, hosted by the Louisiana Department of Insurance (LDOI) July 26-28, 2010 in New Orleans.
- **AICP South Central Chapter E-Day** July 28, 2010 in New Orleans.
- **Seventh Annual Louisiana Filing & Compliance Seminar** facilitated by the Louisiana Department of Insurance, July 29-30, 2010 in New Orleans.

More information is available on the LDOI's Web site at [www.lidi.state.la.us](http://www.lidi.state.la.us) and on AICP's site at [www.aicp.net/chapters/southcentral.cfm](http://www.aicp.net/chapters/southcentral.cfm). What an opportunity to get the most out of your travel dollar. One airfare to New Orleans — one week at the same hotel — and three concurrent educational events. Make your reservations today.



# Regulatory Roundup

by Stroock & Stroock & Lavan LLP

## **New York — New York Insurance Department authority to review health insurance premiums reinstated**

On June 9, New York Governor David Paterson signed Bill No. 278, a bill that reinstates the New York State Insurance Department's authority to review and approve premium increases with respect to health insurance. Prior to the signing of the bill, New York adhered to a "file and use" law that allowed insurers to use new rates immediately after filing. The new law will take effect on October 1, 2010 and will require health insurers and HMOs to apply to the Insurance Department to implement rate increases. Regulators will review the justifications given for the proposed rates and will have the ability to approve, modify or disapprove the rates.

In addition, policyholders and the general public will be allowed to comment on the proposed rate increases. The Insurance Department will be required to post any relevant comments on its Web site to provide a forum for discussion. Small businesses and individuals will also receive 60 days notice of rate increases allowing them more time to consider alternative coverage options. The new law also requires health insurers and HMOs to spend more premium dollars on medical claims by increasing the percentage of premium dollars required to be spent on actual medical care to 82% for both small businesses and individuals.

The loss ratio will be increased in order to ensure that a greater percentage of premiums will be returned to consumers in the form of benefits. Governor Paterson's goal in signing Bill No. 278 is to help make health insurance coverage more

affordable and allow more small businesses and individuals to keep their coverage. To learn more about Bill No. 278, visit [www.ins.state.ny.us](http://www.ins.state.ny.us).

## **Michigan – Court of Appeals upholds order denying state property insurer 18.9% rate increase**

On June 8, the Michigan Court of Appeals upheld a 2008 order issued by Ken Ross, Commissioner of the Office of Financial and Insurance Regulation. The order had denied the Michigan Basic Property Insurance Association an 18.9% rate increase on its homeowners' insurance rates. The Court of Appeals reversed a decision of the lower court and found that the Commissioner properly applied Michigan law when he determined that Michigan Basic Property Insurance Association's ratemaking was flawed. Michigan law states that Michigan Basic Property Insurance Association's "home insurance rates" must be equal to the weighted average of the ten voluntary market insurer groups that have the largest premium volume in the state.

Traditionally, Michigan Basic Property Insurance Association averaged the base rates of the top ten insurers even though state law required them to use weighted average rates. Base rates are the rates that insurance companies adjust up or down to reflect certain risk factors. Weighted average rates reflect the different assigned weights given to each rate — these weightings determine the relative importance of each rate on the average.

Due to new rating factors used by the top ten insurer groups, the Commissioner found that using the average of the base rates was no longer appropriate or lawful, and ordered Michigan Basic Property Association to base rates on the weighted average premium charged by the top ten insurer groups instead. To learn more about the Court of Appeals decision, visit [www.michigan.gov/dleg/0,1607,7-154-10555-238392--,00.html](http://www.michigan.gov/dleg/0,1607,7-154-10555-238392--,00.html).

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The New York-based Stroock & Stroock & Lavan LLP Insurance Practice Group includes Donald D. Gabay, Martin Minkowitz, William D. Latza, Boris Ziser, Thomas Weinberger, Bernhardt Nadell and Keith Andruschak. The Insurance Practice Group also includes insurance finance consultants Vincent Laurenzano and Charles Henricks. They gratefully acknowledge the assistance of Amy Lyons, an associate in the group. This column is intended for informational purposes only and does not constitute legal advice.

## The Will to Regulate

**Item:** Government inspection reports show BP's Deepwater Horizon oil rig was only inspected six times in 2008 even though government regulations say drilling rigs should be inspected every month. In total, the rig missed 16 inspections since January 2005, according to the documents. (Source: CBS News)

**Item:** Joe Main, the Assistant Secretary of Labor for Mine Safety and Health, told a Senate committee that the Mine Safety and Health Administration will start using its power to immediately shut down mines engaging in unsafe behavior. Main said the powers have existed for decades but were never used. (Source: CNN)

**Item:** The heads of the Securities and Exchange Commission and the Federal Deposit Insurance Corp. said [in January 2010 testimony] that shortcomings in their agencies, coupled with flaws in the larger regulatory system, contributed to the period of great boom and even greater bust. (Source: *Washington Post*)

This has not been regulation's finest moment. Not only have financial services regulators let down the public they pledged to serve, but regulators of various stripes have fallen far short of the mark. Now we face the worst economic conditions since the Great Depression and an environmental assault of historic proportions.

Regulators, however, are only partly at fault — there are plenty of other culpable parties. But doesn't it seem that somewhere along the line the regulatory community lost its collective backbone? Perhaps glaring profits blinded these federal agencies to the dangers of "laissez-faire" regulation. Or maybe cheerleading from the sidelines began to feel more comfortable than rigorously enforcing the ground rules.

In short, it seems as if these public servants lost the will to regulate. Rules and regulations,

after all, are only as strong as those charged to enforce them. Drilling rigs were required to be inspected once a month, but they weren't. Experienced staffers should have conducted oil rig inspections, but they didn't.

When the staff of a regulatory agency lacks the will to regulate, a truckload of regulations won't help avert the next disaster. That's the common thread running through the three items at the top of this piece. Regulations were there. Where were the regulators?

And regulators that lack the will to enforce current regulations are not likely to be good at anticipating future problems. Regulators, it seems, are always fighting yesterday's crisis at the expense of tomorrow's.

Last May, when the Dow Jones average plunged by 1,000 points in less than 30 minutes, "high-speed electronic trading" based on indecipherable algorithms was blamed. Since then, we've heard very little about this potentially explosive issue.

Quantitative finance expert, author and publisher Paul Wilmott sees high frequency trading as a looming danger. So does Bernard Donefer, former electronic trader and author of a recent *Journal of Trading* article, "Algos Gone Wild." Could high-speed electronic trading usher in our next economic crisis? We hope not. Are regulators prepared? We hope so.

One last thing: Insurance regulators should be proud that they did not significantly contribute to the regulatory lapses that led to the financial crisis. The reason state insurance regulators fared so well over the past few years is that they, unlike their federal brethren, resisted the call to self-regulation, kept their eye firmly on the ball, and never lost that will to regulate.

— W.C.

# Albuquerque

## 2010 IRES Career Development Seminar

AUGUST 29-31, 2010 HYATT REGENCY

Fill out and mail to IRES: 12710 Pflumm Rd, Suite 200, Olathe, KS 66062

### Registration Form

Yes! Sign me up for the IRES Career Development Seminar.  
Enclose a check payable to IRES or go to our Web site and register online.  
[www.go-ires.org](http://www.go-ires.org)

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Your mailing address Indicate:  Home  Business \_\_\_\_\_

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Area code and phone \_\_\_\_\_ \$ \_\_\_\_\_  
Amount enclosed or pay online

**SPECIAL NEEDS:** If you have special needs addressed by the Americans with Disabilities Act, please notify us at 913-768-IRES (4737) at least five working days before the seminar. The hotel's facilities comply with all ADA requirements.

**SPECIAL DIETS:** Only those requesting a special dietary meal in advance will have one available during the CDS.

Circle: Diabetic Kosher Low salt Vegetarian

**Hotel Rooms:** You must book your hotel room directly with the Hyatt Regency Hotel. Call group reservations at 888-591-1234 or hotel direct at 505-842-1234. The IRES convention rate is available until July 29, 2010 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.

\$140.00 Regulator hotel rate

\$165.00 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 29, 2010. 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, 2010.



#### Seminar Fees

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

##### Check box that applies

IRES Member (regulator)..... \$330

Industry Sustaining Member.....\$550\*

\*REQUIRED: Sustaining Member # SM \_\_\_\_\_  
Lost your number? Send e-mail query to : [ireshq@swbell.net](mailto:ireshq@swbell.net)  
Provide company name and contact information.

Retired IRES Member ..... \$125

Non-Member Regulator ..... \$470

Industry, Non-Sustaining Member ..... \$940

Student Sustaining Member.....\$80

Spouse/guest meal fee.....\$80

PAID Spouse/Guest name \_\_\_\_\_

If registering after July 29 add \$40

**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.**

Call for more details:  
913-768-IRES. Or see  
IRES web site: [www.  
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## What's Inside



Defining  
Medical Loss  
Costs



## BULLETIN BOARD

### ✓ Continuing Ed News

If you are still in need of 15 continuing ed hours, why not come to this year's August 29-31 CDS in Albuquerque and earn the full 15 CE hours required per year. Attend the whole CDS, pick up your attendance certificate and you will receive an automatic 15 CE hours. To find out more about this year's CDS, visit the IRES Web site at [www.go-ires.org](http://www.go-ires.org).

If you are not attending the CDS in Albuquerque, remember you must have your qualifying continuing ed earned by the September 1 deadline. You will then have 30 days to submit your hours to the IRES continuing ed office.

### In the next REGULATOR:

Albuquerque CDS Highlights  
Nashville: The Forgotten Catastrophe

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](mailto:quepasa1@optonline.net).