FEDERAL INSURANCE OFFICE SEEKS INSIGHT FROM INDUSTRY, REGULATORS AND CONSUMERS

By: Roland Goss, Ann Black and Robin Sanders

December 19, 2011

On December 9, 2011, the Federal Insurance Office ("FIO") held a conference on "Insurance Regulation in the United States: Modernization and Improvement." The purpose of this conference was to assist the FIO with its Dodd-Frank Act mandated task of developing a study and report for Congress on insurance regulation within the United States. FIO Director, Michael McRaith, specifically noted that, while the aim of the conference was to address a variety of matters relevant to the FIO's study and report, the goal was not to achieve consensus on any issue discussed. The conference consisted of three panels:

- "Consumer Protection and the Business of Insurance,"
- "International Developments," and
- "Prudential Standards for Insurance Companies."

The panelists included senior executives of life, property and casualty, and reinsurance companies, brokers, a state insurance commissioner, an academic advocate, and consumer advocates. The panels presented high level comments by the panelists, which generally were consistent with positions previously advocated in the media. Although the lack of uniformity of regulation by the states was criticized by some panelists, Deputy Treasury Secretary Neal Wolin, Director McRaith and the panelists generally supported the state regulation of the business of insurance. The principal mention of reinsurance during the conference was criticism during the International Developments panel of what the speaker perceived as slow and ineffective action by the NAIC to reform the collateral requirements for reinsurance transactions involving non-US domiciled reinsurers. Below are key points from each of the panels.

Consumer Protection and the Business of Insurance

This panel was led by moderator, Mark Thresher, CFO of Nationwide and included Daniel Schwarcz, Univ. of Minn. Law School; John Hill, CEO of Magna Carta Companies; Markham McKnight, President BancorpSouth; Johnny Johns, CEO of Protective Life; and Bob Stewart, Consumer Protection Association of America. This panel addressed issues related to the insurance marketplace, consumer protection, and other relevant topics. Each of the panelists had approximately 5-10 minutes to address their perceived strengths and weaknesses in the current insurance regulatory regime and potential solutions for any weaknesses. Key points raised included:

- Several panelists commented that, while the current regulatory structure is largely successful, the following could be addressed as part of the FIO's modernization efforts:
    - Streamline regulatory regimes and market conduct examinations by, among other things, reducing the costs and burdens associated with conducting business across state lines;
    - Revise the structure of the NAIC to make it run more efficiently and reduce its focus on addressing hot-button issues; and
    - Specifically, as to the life insurance industry, coordinate the numerous and fragmented entities that have oversight over the industry (FINRA, SEC, state insurance departments, *etc.*).
- One panelist opined that state insurance regulations are lacking because "very little attention [is] given to transparency" regarding, among other things, product costs and benefits; a second panelist concurred with this comment.
- After concluding their individual remarks, the moderator opened the floor to the audience for questions and comments. During this portion of the presentation, the panelists addressed matters including, but not limited to, proposals on how the FIO may assist in addressing the weaknesses in the current regulatory regime that were identified during the panelists' comments.

International Developments

This panel was led by moderator, Brian Dupperreault, CEO, Marsh and included panelists Walter Bell, Chair, Swiss Re NA; Mark Grier, Vice Chair, Prudential; Christopher Mansfield, SVP/GC, Liberty Mutual; Eleanor Kitzman, Insurance Commissioner, State of Texas. This panel focused on (1) the role of the Director of the FIO as the voice of the United States on insurance issues internationally, both in terms of regulatory issues and promoting United States-based insurers, (2) the importance of the United States obtaining an equivalency designation under the European Solvency II initiative, and (3) several issues of interest to the companies represented on the panel. Key points raised included:

- One panelist noted that the NAIC has been active in international organizations such as the International Association of Insurance Supervisors, but that many United States-based companies have limited foreign operations.
- Another panelist addressed the oft-stated concern that those charged with implementing the system risk provisions of Dodd-Frank or similar standards in the international arena should assess any systemic risks presented by insurance companies realistically, and not automatically treat insurance companies the same as banks.

- Other issues touched upon by panelists were (1) the desirability of a single international regulator, as opposed to multiple regulators, whether in the form of a supervisory college or otherwise; (2) converging international accounting standards; (3) the need for a realistic focus on the adequacy of increased capital and reserve levels, instead of a formulaic risk based capital approach; (4) competitive problems in some markets such as access to markets and repatriation of profits; and (5) the importance of regulatory oversight not providing an advantage or a disadvantage to companies based in a particular country.
- One issue mentioned by more than one panelist was the need for there to be a "level playing field" for all companies domestically and internationally. It was noted that a number of issues may tend to make for an "unlevel" playing field, including varying capital requirements and varying requirements for collateral for reinsurance obligations. This was one area in which the lack of uniformity in the regulation of insurance by the various states was criticized.
- Considerable time was spent discussing the importance of the United States obtaining an equivalency designation for purposes of Solvency II and the market access and competitive disadvantages, which would result for United States-based companies in the absence of such a designation.

Prudential Standards for Insurance Companies

This panel was led by FIO Director, Michael McRaith, as moderator, and included panelists Janice Abraham, President of United Educators; Marlene Debel, Treasurer of Metropolitan Life; Forrest Krutter, Secretary of Berkshire Hathaway Inc.; and Birny Birnbaum, Executive Director of the Center for Economic Justice. During this panel, each panelist spoke on their views about insurance solvency regulation and then Director McRaith asked the panelists their views on several questions. Key points raised included:

- One panelist cautioned that in adopting any new regulation, the regulators need to take into account whether the new regulation: (1) is unduly burdensome on small and middle size companies and thereby reduces competition; or (2) prevents insurers from developing new products that consumers need.
- Statutory accounting principles are focused on protecting policyholders because they focus on the liquidation value of the insurer as opposed to United States generally accepted accounting principles and international financial standards that measure the going concern value of the entity.
- Two panelists expressed concern about the use of black-box modeling for solvency. One panelist explained that due to the similarities of the models, all insurers will act the same way in response to the models.

And, if the models fail in unforeseen circumstances, then that can create a systemic or contagion risk. Another panelist believed that a risk-based capital system is a far superior approach because it tailors the amount of capital based upon the risk undertaken and the assets held by the insurer.

- Most panelists believed that no insurance company should be viewed as a systemically important financial institution. One panelist asserted, however, that credit related insurers (*i.e.*, bond, mortgage, and title insurers) were systemically important given the limited number of insurers in this market, explaining that, since a large segment of the financial market is comprised of mortgage-based or bond-based securities, if any one of these insurers failed, it could have a negative impact on the financial markets.
- The lack of failures of insurance companies is not an indicator of successful state insurance regulation. Most agreed that with competition, some failure is inevitable. The key is what happens upon the failure - are consumers protected. Moreover, if there are no failures, this may reflect regulation so strict that insurance companies are not offering insurance products that consumers need.

If you have any questions or would like further information, please contact Roland Goss at (202) 965-8148 or rcg@jordenusa.com, Ann Black at (305) 347-6859 or ay@jordenusa.com, or Robin Sanders at (202) 965-8119 or rms@jordenusa.com.

****

This article does not constitute legal or other professional advice or service by JORDEN BURT LLP and/or its attorneys.

Roland Goss is a partner with Jorden Burt LLP, resident in its Washington, DC office.
Ann Black is a partner with Jorden Burt LLP, resident in its Miami, Florida office.
Robin Sanders is an associate with Jorden Burt LLP, resident in its Washington, DC office.