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Change Takes Center Stage at NOLHGA's 19th Annual Meeting

By Sean M. McKenna

While introducing D.C. Insurance Commissioner Lawrence Mirel to attendees of NOLHGA's 19th Annual Meeting, Robert Willis (administrator of the D.C. Life and Health Insurance Guaranty Association) praised Mirel for possessing what he called "the courage to make change."

Willis's praise could easily be applied to the more than 160 people who attended the meeting. The theme of the meeting, after all, was "The Direction of Change," and it featured a program that addressed both the economic and political changes facing the life insurance industry and the guaranty association system. With speakers from Capitol Hill, the ACLI, and the financial services sector, attendees were treated to a multi-faceted view of the industry and how it might look in the years to come.

The program for the meeting, which was held at the Monarch Hotel in Washington, D.C., on October 31 and November 1, did more than simply catalog potential changes to the industry. Instead, speaker after speaker gave attendees insight into how NOLHGA and its members could influence the changes likely to take place over the next few years. The meeting program made clear that NOLHGA must do more than simply follow change; instead, it must use all the resources at its disposal to ensure that any changes that do occur are beneficial to both the industry and the guaranty associations' ability to protect policyholders.

Former NOLHGA Chairman Roger Harbin (left), who stepped down from the Board after serving two terms, receives a plaque from Dave McMahon in appreciation for his years of service.

A Unique Perspective

In his welcoming remarks, Commissioner Mirel touched on one of the biggest changes facing the industry, remarking that "the issue of federal versus state regulation is an interesting one for the D.C. department, since we're a little bit of both." He also joked that he liked to test people's support for federal regulation by spreading the rumor that Congressman John Dingell (D-Mich.) had decided not to run for Congress and was instead going to become the first insurance commissioner.

Looking to the future, Mirel charted three possible outcomes for insurance regulation. In the first, state regulation is completely replaced by federal regulation; Mirel described this scenario as "pretty much of a disaster" and added that he didn't think it was very likely. Another possible outcome, he said, was one in which the federal government set standards and left enforcement up to the states. Mirel noted that this outcome is "a distinct possibility, but it has a lot of problems as well."

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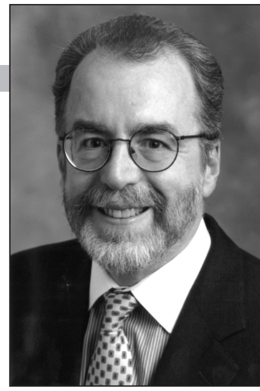
PRESIDENT'S COLUMN

The Direction of Change

By Peter G. Gallanis



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The following is an adaptation of the President's Address at NOLHGA's 19th Annual Meeting.

When confronting great changes, the two greatest challenges always are, first, to identify with precision what important developments are afoot; and second, to attempt to influence them where possible to produce more positive results than what might otherwise transpire.

Thus, the theme for NOLHGA's 2002 Annual Meeting, "The Direction of Change," can be seen as a play on words. During the meeting we have looked at the "direction" of change as a *subject*. In that regard, you've received several presentations on factors in our world that have been and are changing.

But even more important than the "direction" of change as a *subject*, we need to be looking at the "direction" of change as a *predicate*, and asking, "What can we be doing to influence—to *direct*—the ways in which positive change can improve the situations of our members as they work together to meet their obligations to the constituencies they serve?"

Change As a Subject: The answer to the first question (what are the important directions of change as a subject?) will help answer the second question (what can and should we do to help direct that change?). Fortunately, change as a subject has been covered by other speakers at our Annual Meeting (and in other issues of the *NOLHGA Journal*), so I will pause only briefly to itemize the topics that have already been so well addressed: (i) technological developments affecting the industry, particularly computers and the Internet; (ii) macroeconomic developments, such as globalization and consolidation of the insurance industry and financial services convergence; (iii) capital markets trends, including the growth and decline of the recent equities "bubble"—especially for tech and communications stocks and bonds—and the decline of interest rates to their lowest level in generations; (iv) changing norms for corporate governance and accounting and the resulting stricter standards for financial statements and auditors; (v) new risks, such as terrorism; (vi) new, unseasoned products driven by the needs of an aging population and

> *Constant vigilance and involvement in the [optional federal chartering] debate is a price that we must be prepared to pay if the virtues of this system are to be retained.*

insurance industry efforts to compete with banks and securities firms; and (vii) recent negative assessments of the industry by ratings agencies and the financial press.

"Constitutional" Change: Federal Involvement in Insurance Regulation: The Gramm-Leach-Bliley Act of several years back established the first-ever insurance regulatory beachhead for the federal government, and congressional debates over federal terrorism reinsurance widened and deepened that beachhead. Over the past year, a series of hearings by the House subcommittee on capital markets and insurance focused on whether state regulation is impairing the competitiveness of insurers and their ability to provide good service and favorable rates to consumers.

Virtually all proposals floated to implement optional federal chartering regimes would maintain the role of the existing state guaranty associations to protect policyholders of both state and federally chartered insurers. But to the extent that this result is a victory, it is neither final nor irreversible. As the lead counsel to the House Financial Services Committee, Robert Gordon, has told us at this Annual Meeting, the optional federal chartering debate is only beginning. Our system is far from the only issue in play. Constant vigilance and involvement in the developing debate is a price that we must be prepared to pay if the virtues of this system are to be retained.

Although NOLHGA does not lobby, it has always been part of the organization's function to provide information to opinion leaders in Washington and at the NAIC about the work of its member associations, and to serve as a liaison to the NAIC and the federal government.

In that regard, our Financial Services Modernization Committee has supervised and directed an effort to make sure that decisions in Washington about the future of the nation's safety net for life and health insurance policyholders will be made only on the basis of full knowledge of the nature, history, efficiency, and strength of our system.

State Regulatory Modernization: Whether of not optional federal chartering ever arrives, state insurance regulation is more important to guaranty associations today than it ever before has been. On this front, much of the recent news is good. NAIC members have shown a clear desire to modernize, streamline, and fundamentally reengineer insurance regulation. That desire appears to be driven by new faces and fresh thinkers among the ranks of the commissioners; by the very real development of a competitive marketplace for *regulation itself* as a by-product of the federal chartering debate; and perhaps mostly by the fact that it is the proper approach for our time, given the changes already noted.

Change (and Its Direction) as a Verb: With major change taking place in those various directions, we ask the question, "What can we do to *direct* change?"

Many of the changes that we have recognized involve social or macroeconomic trends that we cannot hope to direct, such as technological innovations, capital market developments, and economic trends for the insurance industry in general. However, we can and must assess the impact of these "environmental" developments on the guaranty system and how they will affect our ability to satisfy our future obligations. In particular, we must consider how these developments will influence guaranty association responses to major national insolvencies. What we *can* change and direct is the way *we* respond to the different ways issues will present themselves to us as a consequence of the changed environment. Stated plainly, we can alter our "playbook" as needed to respond to today's challenges.

In that regard, over the past year NOLHGA staff members have been consulting with administrators and member companies of NOLHGA's member guaranty associations in an effort to identify both the specific key challenges that have been presented in major insolvencies of the past and the ways in which our system responded to those challenges. Further, we have worked with the members of our Emerging Issues Committee to identify the new challenges that will be presented as a consequence of the social, economic, industry, and technological changes since the wave of large insolvencies in the early 1990s, all with a view toward developing proposals for changes in our response strategies.

> *While the Washington debates are important, there has never been a better time to work for the improvement of state regulation, including particularly the regulation of troubled companies and the administration of insolvent carriers' estates.*

The Direction of Regulatory Change: At the NOLHGA Legal Seminar in August, Illinois Insurance Director Nat Shapo commented that "Congress is really where the ball game is" in today's debates about insurance regulation. While the Washington debates are important, there has never been a better time to work for the improvement of state regulation, including particularly the regulation of troubled companies and the administration of insolvent carriers' estates.

On that score, the NAIC's Insolvency Task Force is now exploring, as one of its charges for 2003, ways to improve and extend, in appropriate situations, communications between regulators facing troubled company situations and both receivers and the guaranty system, even prior to commencement of formal company insolvency proceedings. This pending revision to the Task Force's charge in part responds to discussions among the commissioners dating back to December 2001 about the benefits of early guaranty association involvement in potential insolvencies. It may be a harbinger of a new era of enhanced communications and cooperation among regulators, receivers, and the guaranty systems that would bring to the subject of troubled companies the same type of regulatory modernization that has been pursued by the NAIC in other areas. This topic is so important and complex that it likely will be the subject of a separate column in the near future.

Conclusions: Change is clearly afoot in many areas that will, without doubt, affect the life and health insurance guaranty associations.

All change must be addressed dynamically. If we wait passively for the consequences of change to come to us, we leave ourselves in the position of allowing other actors or circumstances to dictate our delayed reactions. In certain cases in the past, we might have believed we could allow that to happen, but we can no longer afford it.

Instead, we must seek to identify and appraise changes that may affect us *not* when those changes are almost upon us, but rather when they are just commencing. Where we have identified such a development—the *direction* of a change—we must consider what we can and should do to influence the development itself, our manner of dealing with it, or both, so that we can then *direct* the changes needed for us to perform our duties in the exemplary manner that the public rightfully has come to expect. ■

A Friend in Pennsylvania

By Larry Henry & Sean M. McKenna

It's late May 2001, and Fred Buck, president of Buck & Associates and project manager of NOLHGA's Reliance Insurance Company Task Force, is performing due diligence on Reliance's A&H business. At this point, the Pennsylvania Insurance Department had yet to place Reliance into liquidation—in fact, the company had been placed into rehabilitation just a few days before Buck's visit.

What's going on here?

On the one hand, it's a simple matter of the Pennsylvania Insurance Department realizing that Reliance's A&H business is a small piece of a very large pie—the company's failure was the largest P&C insolvency ever. As Joe Horvath, executive director of the Pennsylvania Life & Health Insurance Guaranty Association, points out, "it was such a small part that the department couldn't logically allocate too many resources to it." So, enter NOLHGA with a vested interest and available resources.

Still, there's nothing simple about a state insurance department granting a NOLHGA task force access to a company's claims files and asking them to perform due diligence at such an early stage. "The department trusted us enough to let us do it," Horvath says. "That's kind of unusual."

A Running Start

Bringing guaranty associations in so early may be out of the ordinary, but according to Joe DiMemmo, director of Liquidation Administration for the Pennsylvania Insurance Department, it makes perfect sense.

"One of the missions of the department is to protect the policyholders," he says. "By embracing NOLHGA's participation early on, we're able to provide policyholders the best service we can by having them receive their policy benefits in a much more timely manner than if we began the process at the time of liquidation. Our commissioner, Diane Koken, feels very strongly that policyholder protection is our number one priority."

The department's proactive approach to troubled companies is designed to give the guaranty associations and the department as much time as possible in preparing for an insolvency. That means sharing information and working together to map out the full extent of policy obligations well before a company is declared insolvent.

"It's a planning process that enables the associations to get a running start," DiMemmo says, "to prepare to pay claims or transfer policy obligations should there be a liquidation."

> *"We were able to provide a seamless transition for the policyholders. And the only way we were able to do that was by getting NOLHGA involved early."*

For multi-state insolvencies, the department's desire to have a liquidation plan in place well before liquidation is declared necessitates bringing in the NOLHGA task force as early as possible. That's why Buck was at Reliance two days after it was placed in rehabilitation.

It's a process that benefits both sides. The department taps into the expertise of the NOLHGA task force as it prepares for liquidation, and the task force gets a huge jump on its work. "It's good for us, because we have our due diligence done early," Buck says. "So if the company goes into liquidation, we have our ducks in a row so we can act quickly."

Building Trust

Needless to say, this process doesn't work without a commitment from both sides. The department and the guaranty association system "have a degree of trust and cooperation that I think is unparalleled" in insolvency management, says Buck, who's worked on enough task forces to know. DiMemmo and Horvath echo the sentiment; the two sides work together beautifully.

One reason for this is that they've worked together for so long. NOLHGA and the Pennsylvania Insurance Department have a history together, dating back to the Summit National Life Insurance Company insolvency in 1994—the department's first experience with a NOLHGA task force, according to DiMemmo. The beginnings of the Pennsylvania department's aggressive approach to insolvencies, as well as the close working relationship between the department and the guaranty associations, took shape during this insolvency.

"We began very early after we took over as rehabilitator to get NOLHGA involved, because we suspected at the time that it might be a liquidation," DiMemmo says.

The task force also entered into the process ready to help in any way. Buck, the project manager, took the lead.

"I had just come off being a receiver for Pacific Standard," he says. "To engender some goodwill, I gave [the Summit liquidation team] form letters, reports—all the things I had done in the Pacific Standard insolvency—so they didn't have to recreate the wheel. I think that probably started the great dialogue with that receiver and the department."

The dialogue proved to be a success. When Summit was declared insolvent, work on an offering memorandum and assumption agreement was already complete. "The day the company went into liquidation, the policy obligations of Summit National were transferred," DiMemmo says. "We were able to provide a seamless transition for the policyholders. And the only way we were able to do that was by getting NOLHGA involved early."

This success prompted the department to ask for Buck and many of the same task force members when another Pennsylvania insurer, National American Life Insurance Company of Pennsylvania (NALICO), was placed in rehabilitation the next year. Following the formula established in the Summit National insolvency, the department and the task force were again able to transfer the policy obligations on the first day of liquidation.

Success breeds success, but work on Summit National and NALICO did more than that; it gave the department and the task forces an opportunity to understand each other.

"We had to learn about each other's roles and how we discharged them," Horvath says. "They're much better-informed about how we operate, just as we're much better-informed about how they operate. It's taken years, but it's happened."

According to everyone involved, it's been time well spent. "It's a matter of establishing trust and respect for each other," Buck says. "That's not something you do overnight. That's something you do over time."

Communication & Confidentiality

The foundation of this trust and respect, not surprisingly, lies in the skills and professionalism of department staff and task force members alike. DiMemmo raves about the talents of Buck and other NOLHGA task force members; the department even recommended to the federal government that Buck be made trustee of Conestoga, a small insurance company affiliated with Summit National.

Buck is just as high on Pennsylvania Insurance Department personnel. "These people have a lot of experience in liquidation," he says. "Most of them have been there 15 years or more. They have a very high skill level."

Another key to the close working relationship that's developed between the department and the guaranty association system is the sharing of information that goes on during a rehabilitation or liquidation.

"I think constant communication helps," Buck says. "If you're involved in an insolvency, it can realty bite you in the butt if you're not careful. And the way you avoid that is to keep in constant communication with the people involved."

The communication runs both ways, Horvath says, with each side informing the other when trouble is on the horizon. "We don't let the department be blind-sided, and they've been good about giving us advance warning of things to come."

Although communication plays a major role in the Pennsylvania Insurance Department's approach to troubled companies, the department's obligation to protect the interests of a company's stakeholders means that some information must remain private.

> *"Policyholders get paid faster," Horvath says. "The initial communications are better, the follow-ups are better."*

"Everything we do in rehabilitation, in terms of providing information, is under a confidentiality agreement that is signed by NOLHGA," DiMemmo says. "Everything we provide is still protected; the company really shouldn't have any concern that some proprietary information is going to leak out."

A Win-Win-Win Situation

As noted earlier, the driving force behind the Pennsylvania Insurance Department's decision to work with NOLHGA task forces during the rehabilitation phase is its desire to offer the best possible protection to policyholders by allowing the guaranty associations to get a "running start" in fulfilling their obligations. As Summit National and NALICO demonstrated, the department's approach has proven effective.

"Policyholders get paid faster," Horvath says. "The initial communications are better, the follow-ups are better. There's probably less anxiety."

The department benefits from this approach as well, not only in the service it provides to policyholders but also in the services the guaranty association personnel provide to the department. Buck cataloging the A&H obligations of Reliance may be an extreme example, but it shows how the department makes use of the expertise that lies in the guaranty association community.

"When we got into Reliance, we actually didn't know what we had," DiMemmo says. "Our claims administration manager, Paula Hower Clausen, suggested we get Fred in to dig out exactly what Reliance did have—not only to prepare if we went into liquidation, but just to let us know what our policy obligations and liabilities would be. In reality, nobody had a good handle on the A&H business at Reliance prior to Fred coming in."

Buck points out that the task force also benefited from this arrangement. "If you're in early and you get the information before the hectic part of liquidation, you're much better off," he says. "You don't start from square one on liquidation day. You've got the knowledge base over a period of time that you usually have to build over a period of minutes. And you don't spend 90 days after liquidation trying to negotiate an early access agreement."

In fact, the Pennsylvania department's emphasis on being ready to handle claims on day one of liquidation makes those agreements much easier to obtain.

"We try to provide as much as we can as quickly as we can, in terms of early access," DiMemmo says. "That has worked well. Across the country, you're probably not going to see a liquidation department that has given out as much early access as we have, as quickly as we have."

An Example To Follow?

While a history of success has played a large role in the Pennsylvania Insurance Department's policy of bringing guaranty associations into the insolvency process as early as possible, DiMemmo and the others agree that the approach will work elsewhere. Buck thinks the guaranty associations can take the first step.

"One thing to do is establish contact early on—get in early in the rehabilitation and offer whatever assistance you can before you're triggered," he says. "You can even

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"Our Mission Is One of Service": An Interview with PA Insurance Commissioner Diane Koken

Diane Koken was confirmed by the Pennsylvania Senate as Insurance Commissioner for the Commonwealth of Pennsylvania in December 1997 and in February 1999, but her commitment to the industry and its consumers has spanned her entire professional career. Prior to her appointment, the commissioner was vice president, general counsel, and secretary for a major life insurer.

As a member of the Governor's Cabinet, the commissioner is responsible for the regulation of the insurance industry in Pennsylvania (which ranks in the top five in insurance premium volume in the country) and the protection of the insurance consumer.

Q: What challenges do insolvencies present to you and your department?

A: The decision to take over a troubled company, particularly one of the size and scope of some of our recent insolvencies, is reached only after careful, painstaking review of the relevant facts. The foremost priority in our decision to petition the court to place any company into liquidation is policyholder protection.

The Insurance Department has put together a top-notch, highly experienced rehabilitation/liquidations team. This team, composed of experienced insurance executives and receivership experts, is generally already on-site and in place when a company goes into liquidation. They work diligently to see that the liquidation goes as smoothly as possible.

So I believe I have been very fortunate to have this team in place. They have been up to any challenge I have given them—and then some.

We continue to aggressively marshal all available assets of the company for use in liquidation. To avoid delay of claim payments during this transition period, I generally ask the court to approve the continuation of the timely payment of workers compensation and personal injury protection claims. Also, company employees who have worked diligently during the rehabilitation process are helpful to have in place in the liquidation process as well. So we are sensitive to those employees, and we focus on making the transition into liquidation as professional and smooth as possible.

Q: What has been the biggest challenge presented to you by an insolvent company?

A: I have learned that every rehabilitation and liquidation is a unique situation, with its own set of problems and challenges. The larger the insolvency is, however, the greater the coordination of services and resources.

Q: How do NOLHGA and the Pennsylvania Life and Health Insurance Guaranty Association fit into your vision of dealing with troubled companies?

A: We are more proactive in our dealings with the guaranty association system. We try to involve the national organizations in the planning process at the earliest date possible. Both NOLHGA and the NCIGF have had representatives on-site at the Legion/Villanova rehabilitations almost from the first day. This has been valuable in planning a possible transition to liquidation.

Q: How would you describe the relationship your department shares with the Pennsylvania guaranty association and with NOLHGA?

A: I believe our relationship is a hardworking one, professional and very spirited. We understand that communication is key to any good relationship, and that is certainly the case here. Just as in any relationship, it takes consistent effort and a willingness to be aware of the other person's perspective to have any degree of success. And so I am realistic too. While the regulator and NOLHGA share common goals, we each have different constituencies to consider.

Q: How does the cooperation between your department and the guaranty association system benefit the policyholders?

A: I believe that the guaranty fund system is an important consumer protection that is unique to the insurance industry. The primary goal of any rehabilitation or liquidation action is to see that policyholders are protected and policyholder claims are paid to the fullest extent possible. Once a liquidation order triggers the action of the guaranty associations, transitioning claim payments is critical. So making the proper preparations lays the groundwork to see that this goes smoothly.

Q: What benefits do the department and the guaranty association enjoy from the close working relationship?

A: Again, I certainly can't say this enough. Communication is the key here. And ultimately, it is neither the regulator nor the guaranty association that really benefits from this working relationship. It is the consumer who should and does benefit.

Q: How have you gone about establishing this relationship with the guaranty association system in your department?

A: The Pennsylvania Insurance Department is organized into divisions, or deputates. We have a deputy commissioner who is responsible for liquidations and who oversees our work with the guaranty associations. I believe that it is critical to have a senior-level executive whose work is focused on this very important area. This is someone with whom I communicate on a daily—sometimes hourly—basis.

Q: Has your background serving on the Pennsylvania and Delaware guaranty association boards helped you in your efforts?

A: Going along with that theme of communications, it is always helpful to appreciate the perspective from both sides. Having served on both the Pennsylvania and Delaware boards, I understand their issues.

Q: Could you talk a bit about your department's policy of taking legal action against officers and directors of failed insurance companies? How did you arrive at this policy, what does it mean for your department, and how does it benefit the policyholders?

A: We are aggressive in doing everything we can to marshal assets to pay policyholder claims. We are also very committed to holding responsible parties accountable for their wrongful actions. So our strategy has been to learn what went wrong and what parties might be responsible for a company's demise and determine the appropriate next step. In many cases, the appropriate next step is to file a complaint and take legal action against those parties.

Q: What has been the biggest challenge you've faced as commissioner?

A: Well, I think dealing with Bill Taylor [deputy commissioner of the department's Office of Liquidations, Rehabilitation, and Special Funds] has been quite a challenge!

All kidding aside, as I mentioned before, each of us has a certain perspective. What I find challenging is to make sure that I am taking into account all of the varying perspectives.

Also, we as regulators are so busy and are stretched in so many directions, sometimes we become task masters rather than what we really need to be—and that is innovators, planners, and yes, in some cases, visionaries. For if you don't have a vision, you are really just stumbling along a corridor that someone else has designed.

Q: What has been your most rewarding experience in your time as commissioner?

A: What I had learned in the field of law has proven to be true for me as an insurance regulator as well. By that I mean that the work is always humbling and there is always so much more that needs to be done.

In the morning you may be a winner, but by afternoon you may have suffered a loss. The rewarding part comes in knowing we do wear the "white hats," that our mission is one of service. What we do does make a difference.

I feel we have been willing to tackle some significant challenges during a very volatile time in the industry. I am proud of that. Going to bed at night knowing that, collectively, we have done good and important work is rewarding to me.

Q: Looking to the future, what are your goals for your department in terms of preventing insolvencies and dealing with them when they occur?

A: In terms of solvency monitoring and prevention, I do believe that the regulators have some very effective tools in our arsenal with Pennsylvania's new risk-based capital law. We have the ability to recognize problems sooner and begin remediation, thus reducing the incidence of insolvencies. In actuality, the Pennsylvania Department has turned around more than 30 insurance companies just since I have been commissioner.

Can we do more? Yes, that is always the case. Regulation is an ever-evolving process, and we are constantly learning. We need to continue to develop tools to prevent insolvencies without over-regulating the industry.

We also need to be realistic that in a free market society it may not be possible to prevent all insolvencies. But then that's why we need the guaranty association system—to protect policyholders. ■

Friend in Pennsylvania

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offer to do some of their work, like the A&H stuff. It's work you're going to have to do anyway."

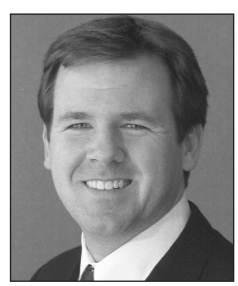
From that point on, he says, constant communication—what he calls staying on their radar screen—is crucial to reminding the insurance department that the guaranty associations are ready to help at any time.

From DiMemmo's perspective, confidentiality is the bedrock of the relationship. "If it came to a point where information on a company in rehabilitation was leaking out, I think there would be a big push to stop what we're doing and make sure the integrity of the company is protected first," he says.

Provided the confidentiality is in place (and he adds that NOLHGA task forces have honored Pennsylvania's confidentiality agreement), DiMemmo believes that early guaranty association involvement has helped his department serve policyholders better—and he sees no reason why other departments wouldn't experience the same success.

"As long as there's a spirit of cooperation and the confidentiality is maintained, I don't know why any states couldn't use the same process to improve their operations of companies in rehabilitation or liquidation," he says. "It's not scientific. It's just basic common sense." ■

Larry Henry is manager of insurance services for NOLHGA.



Sean M. McKenna is the communications manager for NOLHGA.

"In Time of Peace, Prepare for War"

By Daniel A. Orth III

We all know that "guaranty association" is not a household term. We have come to expect (and even to accept) quizzical looks; we anticipate the "guaranty who?" question, and we have certainly grown accustomed to the glazing over of eyes when we explain what a guaranty association is and how it works.

That said, we continue to be surprised when we receive what I call "the blank stare" from those we believe should have some grasp of what we do (such as judges and insurance department personnel) and from people we know have a high degree of sophistication in financial matters, such as bankers. When dealing with these groups, catching sight of the blank stare can be the first sign that trouble is on its way.

The Set-up

Consider this situation: You are a guaranty association administrator, and your association has been triggered by an insolvency. The association has met in full what your board of directors, your legal counsel, and you believe to be its statutory obligations. In the process of meeting its obligations, your association has denied a very large claim (or an aggregation of many claims), based upon what the association believes to be the correct interpretation of an exception to a coverage provision in the guaranty association statute. However, there has never been a review of that provision by a court in your jurisdiction.

The claimants are convinced that you have misinterpreted the statute's meaning and have improperly denied their claims. The amount at issue is huge in relation to any assets the association has on hand. The claimant appeals your claim denial to an administrative hearing, and the litigation war begins. Whatever the result, the losing party takes an appeal to a trial court. The only question before the court is one of statutory interpretation, so this will be a bench trial.

The trial takes place. The court takes the matter under advisement, and you await the outcome. Several weeks drag by. Finally, your attorney calls. A judgment has been entered against your association for the full claim amount in issue, plus prejudgment interest. The total judgment is $10 million!

Left unchallenged, this decision could impact guaranty association exposure in future insolvencies. However, you, your board, and your counsel are confident the trial court has erred, and everyone believes the appellate court will set things right upon appeal. You get the go-ahead to appeal. A wiser, more knowledgeable forum awaits. If you can get there!

> *Some jurisdictions will allow an appeal only if an appeal bond has been issued by a pre-approved property and casualty carrier that issues such bonds.*

The Problem

Once a judgment is entered against the defendant, the plaintiff becomes a judgment creditor. A judgment creditor has the right to collect the judgment against the debtor's assets if the judgment is not satisfied by a payment or if the collection is not "stayed" by the court before expiration of an automatic statutory or rule-of-court period. Let's say in your case this is 30 days.

The filing of an appeal will cause the court to stay enforcement during the appeal, but only if certain procedural requirements for an appeal have been met (this is known generally as perfecting the appeal). These requirements exist partly because the filing of an appeal begins a journey that could take months or even years to complete. During that time the judgment creditor, who believes it has already been delayed in receiving its benefits by the initial denial, the administrative proceeding, and the trial, is now forced to wait even longer. Also, defendants who have lost at the lower court level have been known to file an appeal to create a delay to gain settlement leverage or to put off having to make the payment through the appeal period, only to dismiss the appeal as the date for its hearing draws near.

A court has the power to give the judgment creditor protection against such abuse by refusing to stay the enforcement of a judgment during the appeal period unless the judgment debtor puts up an appeal bond, which is a financial guaranty that the amount of the judgment, plus interest, will be there when and if the judgment ultimately becomes payable. Some jurisdictions will allow an appeal *only* if an appeal bond has been issued by a pre-approved property and casualty carrier that issues such bonds. The appeal bond is usually for the amount of the judgment and any prejudgment interest, plus post-judgment interest for a period of at least the next year. When the year ends, a renewal bond must be filed (for an appropriately increased amount) or the stay will be lifted and the bond will be forfeited to pay the judgment and accrued interest.

The Difficulty

In Greek mythology the gods punished Sisyphus by setting him the task of rolling a great boulder to the top of a hill. While the task was simple, it was far from easy (quite apart from the cruel refusal to ever let him succeed). In today's world, one might expect that it would be both a simple and an easy task for a judgment debtor, especially an association with virtual taxing power over all the life and health insurers in the state, to obtain an appeal bond. Simple? Maybe. You should only need to write a check for the appeal bond premium. Easy? Not so fast. This could be one big rock! Enter the "guaranty who?" factor.

The day may come when carriers that issue appeal bonds won't think twice about accepting an assignment of an assessment from a guaranty association as security to support their issuance of a bond. But that day is not yet here. While such carriers are happy to earn a premium for their issuance of a bond, they minimize the risk they are assuming in the process by requiring collateral. And while they know how to value assets that are usually put up as collateral, be they bonds or buildings, the assessment powers of guaranty associations are uncharted waters.

As mentioned earlier, some court rules (ostensibly in place for administrative ease) require an appeal bond issued by a preauthorized bonding company as the *only* acceptable security for a defendant to perfect an appeal. In these cases, not even a cash deposit to the court will suffice. Of course, a cash deposit would be acceptable to a bond carrier as collateral to support the issuance of an appeal bond. However, to obtain the cash the guaranty association would need to levy, call, and collect an assessment from its members.

In general, the assessment of member insurers should be avoided if alternative ways of raising money are available, especially if the assessment is made to fill a relatively short-term need. Also, some guaranty association statutes permit an assessment only when "necessary," and it is at least arguable that assessments are not "necessary" if alternative ways to raise capital exist.

Moreover, it is not an inconsequential thing to deprive member insurers of capital they could use to conduct their businesses and on which their rate of return may be significantly higher than the cost of acquiring the same capital through some available and conventional means. As Shakespeare put it, "there's the rub."

The Solution

If the guaranty association does not have sufficient assets to serve as collateral and doesn't want to levy and collect an assessment, the bond carrier will accept a letter of credit issued by a qualified financial institution, such as a commercial bank, as collateral for the bond. Enter onto the stage another player—and color the commercial bank skeptical.

Banks have underwriters, as insurers do, to evaluate the risk to the bank when it issues a letter of credit or makes a loan or any similar commitment of funds. Furthermore, just as life insurers have retention limits (i.e., the amount of risk the insurer will retain before it passes off the balance to one or more reinsurers), banks also have limits, set by internal bank policy, on how much the bank will loan to any one customer. Committing to an amount that exceeds the bank's limit may require the bank to make a proposal to another bank

The bank is likely to insist that the association, in advance, take all formal steps short of actually collecting the assessment—such as adoption of board resolutions levying the assessment and calling the assessment—so there are no legal impediments should collection become necessary.

to participate in the letter of credit, i.e., take a piece of that commitment and risk and earn some of the fee charged. When a second bank participates, the syndication may be invisible to the borrower because the letter is issued only by the first bank, but such participation does add the likelihood of another blank stare. More questions are certain to be raised by the participating bank. Answering them will take time, and the 30-day window is closing as each hour and day go by.

One element that will certainly be required when obtaining a letter of credit from a commercial bank is an opinion from a law firm engaged by the bank that the guaranty association has the statutory power to assess the needed funds and the legal ability to assign its right to collect funds raised by the assessment(s) over to the bank as collateral for the letter of credit. The bank is likely to insist that the association, in advance, take all formal steps short of actually collecting the assessment—such as adoption of board resolutions levying the assessment and calling the assessment—so there are no legal impediments should collection become necessary. The bank will also want the law firm to determine precisely what other guaranty association board action, if any, is necessary to give the bank comfort that, should the letter of credit be drawn-down upon by the appeal bond carrier, the bank cannot be prevented from its right to collect the assessment and use the proceeds to pay off the drawn-down letter of credit.

In any situation where very smart lawyers are given the task of reviewing a complex and esoteric transaction on behalf of a client in search of safeguards, creativity is just around the corner. Very smart lawyers will poke and prod and turn and touch, looking for some additional protection for their client, if only to justify their involvement. It is out of such reviews that banks identify default events (events that accelerate payoff of the letter of credit and trigger collection of the assessment), which are spelled out in an extensive and onerous-appearing document called a credit and security agreement.

The association's board will therefore need to take the formal steps of levy and call, but you will not actually send out the bills and collect the assessment. The bank will recognize, or can be helped to recognize, that if the protections are too onerous, making it highly likely that the guaranty association will be required to actually collect the assessment funds from its member insurers, the association would no longer need the bank's letter of credit. If a default event is too likely, the association might as well just collect its assessment so it will have its own cash to put up as collateral for the mandated appeal bond, even though that would raise the negative of not being the "best use" of member insurer funds. If everyone is reasonable, in the end, the guaranty association finds an alternative to assessment to obtain its appeal bond, the bank gets security for its letter of credit, the bond carrier gets its collateral, and the members avoid the high cost of capital and a cash drain. In theory, everyone wins—sort of.

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"In Time of Peace…"

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Recall that this entire process needs to be completed within a closing window of time. It may not be possible to obtain an extension beyond the statutory or rule-of-court period for an automatic stay. This could depend upon the inclination of the judge, the aggressiveness of the judgment creditor's lawyer, and the effectiveness of the association's lawyer in developing arguments to the court and providing assurances that progress is being made (all without being able to produce any commitments in writing from bond carriers or banks).

Indeed, the testimony of a guaranty association administrator may be required in open court or at an evidence deposition, and this testimony may not be sufficient to persuade the court to extend the stay. In a worst-case scenario, the judge would refuse to extend the stay, an aggressive opposing counsel would order up an asset discovery deposition to locate the guaranty association's assets, and opposing counsel would execute the judgment against the assets of the association wherever they were held. This would shut down the association's ability to pay claims, rent, staff payroll, or even the phone bill. While this would be extreme, General Sherman observed that "war is hell," and litigation is a kind of war.

The Moral

In the U.S. Navy I was exposed daily to a huge sign inside utility squadron VU-4's hanger that read: "Every Navy safety regulation is written in blood." It was effective then, and still serves today, as a reminder to stay focused and to pay attention.

Hence, also, this article's aphoristic title: *"In Time of Peace, Prepare for War."*

The NAIC's 1997 Life and Health Insurance Guaranty Association Model Act contains a provision in section 8Q that says, "The Association shall not be required to give an appeal bond in an appeal that relates to a cause of action arising under the Act." This simple sentence serves as the ounce of prevention needed to avoid the difficulties a guaranty association could face if required to post an appeal bond. If your state has not adopted the NAIC's 1997 (or later) version of the Model Act, and even if you have no prospects for advancing its adoption in its entirety in your jurisdiction, you should make every effort to amend your state's guaranty association law to include at least that single sentence.

The guaranty association is a creature of the legislature. It isn't going anywhere. The funds it raises through its assessments are intended to protect policyholders. Why should guaranty association monies be diverted from their intended purposes simply to provide unnecessary protection to a judgment creditor? Why increase the burden on member insurers through higher assessments to cover needless bank fees, bond premiums, and legal fees? Why reduce premium tax revenues to those states that have tax offsets?

We might wish, or even argue, that a judge should take judicial notice of the legislature's confidence in the ability of a guaranty association to produce the funds required to pay statutorily mandated benefits. A more pragmatic course would be for a guaranty association to seek a statutory amendment before the need arises. Once the need does arise, all you can do may neither be enough, nor in time. ■

Daniel A. Orth III is the executive director of the Illinois Life & Health Insurance Guaranty Association.

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In Mirel's opinion, the best possible scenario would be for the federal government to demand uniformity from the states and allow the states to achieve it; he contrasted insurance licensing with obtaining a driver's license to illustrate how this might work. Each state issues drivers' licenses, but they also honor the licenses of other states. Drivers don't have to obtain a new license for each state they drive through, but they must obey each state's laws. Mirel believes this model could work for insurance licensing, but he added, "to make it happen, we could use a little kick from Congress."

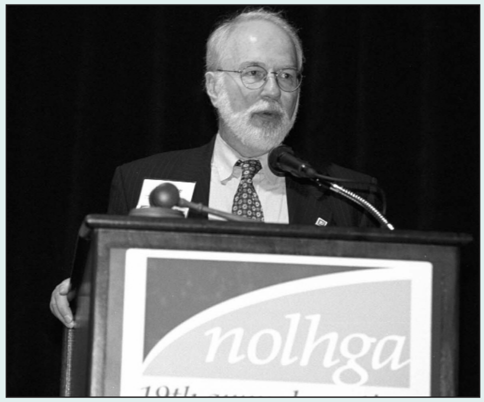
The Congressional Agenda

Although the last congressional term was extremely active where insurance is concerned, Robert Gordon, a senior counsel for the House Committee on Financial Services, said it was "just a warm-up for next term," when the committee hopes to pursue its agenda without other issues (such as the Enron scandal and the 9/11 attacks) taking precedence. He predicted that a terrorism insurance bill was likely to pass both houses and also singled out the Patriot Act, seniors and retirement issues, and the blending of insurance and securities as priorities for his committee.

According to Gordon, the question isn't whether Congress will get involved in insurance industry regulation, but how and when. He said the Financial Services Committee supports the NAIC's Interstate Compact and would like to help the NAIC in its efforts to get states to join. "Congress can sometimes be most effective by using the bully pulpit," Gordon said. "I expect we'll do much more of that."

Speaking on the committee's view of regulatory reform and its possible effects on the guaranty system, Gordon said that "there was definitely an agreement among members that the guaranty funds have worked in the past." He noted, however, that the prospect of a federal charter could complicate things. If a federal charter passes and the guaranty system remains in the hands of the states, he said, there could be a problem if a state guaranty association had to assess a company not regulated by that state. Creating dual guar-

The D.C. Connection



NOLHGA's 19th Annual Meeting had a distinctly "D.C." flavor. Robert Willis (left), the administrator of the D.C. Life and Health Insurance Guaranty Association and former head of the D.C. Department of Insurance and Securities Regulation, began the meeting by introducing current D.C. Insurance Commissioner Lawrence Mirel (center), who spoke about efforts to improve state regulation of the insurance industry and also warned attendees about the dangers class-action lawsuits pose to the industry. Robert Gordon (right), a senior counsel for the House Committee on Financial Services, discussed his committee's ambitious agenda for the coming congressional term, remarking that "it's going to be an extremely active term for Congress next year" and stressing NOLHGA's importance in the ongoing discussion of federal chartering and its effect on the guaranty system.

anty systems (state and federal) could leave some states with an assessment base too small to meet their needs. Creating a new federal system, he added, would entail replacing a working system with a new one that lacks the expertise of its predecessor.

With so many difficult choices, Gordon said, the committee will be looking for expert advice. NOLHGA, he added, "is going to have to be very involved in advising the members of Congress on the ramifications of these approaches."

Mixed Bag for Mergers

Owen Ryan, global insurance industry leader and national managing insurance partner with Deloitte & Touche, analyzed the mergers and acquisitions market and gave attendees insight into some of the difficulties companies face in these transactions. According to Ryan, the key factors in the mergers market are profitability, asset quality, products, and rationalization and consolidation. He noted that the outlook for the industry's products is bright, since the recent scandals on Wall Street have reminded people of the value of insurance

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Politics As (Un)Usual

Washington, D.C., is at heart a political city, but as NOLHGA's Annual Meeting proved, politics can be a lot of fun. Political commentator Fred Barnes, NOLHGA's luncheon speaker, offered his opinions and insights on President Bush, the mid-term elections, and the new political era in Washington. The Capitol Steps, a comedy troupe based in the nation's capital, entertained meeting attendees with their more irreverent—and musical—look at the city's political scene.

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products. "A flight to quality and a flight to safety have taken place," he explained.

Ryan also ran down a laundry list of impediments to successful mergers. One of the most obvious, he said, is that "CEOs have egos" and often do not want to give up control. He added that the requirement that CEOs certify their companies' financial statements has made some CEOs leery about mergers—and the possibility of certifying statements for a company on which little due diligence has been performed.

The lack of a clear acquisition strategy can also lead companies down the wrong path, Ryan said. Many companies simply react to any opportunity that comes their way, but Ryan believes "you should know the companies you'd like to do a transaction with" so that your company will act only when the right opportunity presents itself.

Overall, Ryan said, most mergers fail to deliver the added benefits and value the merging companies expect. These failures, he explained, can be attributed to two causes: failure of strategy and failure of execution. On the execution end, Ryan said, "acquiring is easy; merging is hell. The real hard work is getting integration done."

Combining two companies is difficult for a number of reasons. Ryan noted that many senior managers walk away from a merger once the transaction is complete, when in fact their expertise is even more vital as the companies merge operations; he recommended bringing in personnel experienced in integration to smooth over some of the difficulties. He also warned that employees who will only be with the newly merged company for a short time can be dangerous, since they are often both unhappy and inclined to spread their unhappiness to others. "Those are the people who can really screw up your transaction," he said. "You've got to manage that group very carefully."

A Forgotten Industry?

John Barrett, chairman of the ACLI and chairman, president, and CEO of Western & Southern Financial Group, began his presentation by saying that "2002 has been a tough year for the country, the economy, and the industry in general." Investors' faith in the market has declined along with the value of their 401(k) portfolios, he said, and "Congress is riding the corporate abuse bandwagon."

Another troubling sign, Barrett said, is that the ACLI has found that Congress and congressional staffers don't have a firm grasp of how the insurance industry works, or even what it does. "Too many people have

The Directions of Change

The program for NOLHGA's 19th Annual Meeting offered attendees a look at the life insurance industry and guaranty association system from a number of different perspectives. John Barrett (top left), chairman of the ACLI and chairman, president, and CEO of Western & Southern Financial Group, noted the "public suspicion and mistrust" resulting from recent corporate scandals but predicted that "confidence in management will come back soon." Elizabeth Malone (top right), managing director of research for Advest, Inc., discussed the effect these scandals and other factors have had on the stock market and the industry as a whole, observing that even companies with conservative investment strategies "have been blindsided" by market upheavals. Professor Scott Harrington (bottom) of the Moore School of Business at the University of South Carolina analyzed the impact an optional federal charter could have on the state-run guaranty system. He praised the performance of the current system, saying, "I think the state guaranty associations represent one of the best aspects of federalism" and the states' ability to work together.

forgotten what we do," Barrett said, which is why the ACLI plans an aggressive campaign to educate Congress on the value of insurance. "America simply cannot do without the insurance industry."

Barrett explained that the ACLI is continuing its dual-track agenda of supporting both an optional federal charter and improvements to state regulation, with state reform focusing on speed to market, licensing, and market-conduct examinations. He noted that the relatively short terms served by insurance commissioners are a stumbling block. "The staffs are the people who make those departments go," he said, asking NOLHGA and its members to provide "an additional push" to states to jump on the regulatory reform bandwagon.

In surveying the health of the insurance industry, Barrett expressed concern that "people wait too long before they raise their hand for help," with companies often hoping that improvements in the market will pull them out of financial difficulties. He predicted greater pressure on these companies as ratings agencies take a more aggressive approach in lowering ratings of companies not delivering value. In his opinion, "they've been slow" to do so in the past.

Still at the Station

In his presentation *Optional Federal Chartering and Insurance Guaranty Funds*, Scott Harrington (W. Frank Hipp Professor of Insurance and Professor of Finance at the Moore School of Business at the University of South Carolina) admitted that about a year and a half ago, "I thought the train was leaving the station on optional federal chartering." However, the train has been delayed—though not derailed—by the government's focus on terrorism, and Harrington believes that the NAIC's Interstate Compact could prevent or delay it indefinitely.

According to Harrington, the guaranty system would take one of three forms in a world with optional federal charters: (1) a state-run system, (2) a dual system (a federal guaranty system for federally chartered insurers and a state system for insurers with state charters), or (3) a federal sys-

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New Challenges, New Roles for NOLHGA

David H. McMahon

Thomas D. Potter

David H. McMahon and Thomas D. Potter each used his chairman's address at NOLHGA's 19th Annual Meeting to praise the organization's preparation and readiness and to speak about some of the major challenges it will face in the future.

McMahon made note of the various groups that make up NOLHGA—administrators, state board members, and staff—saying, "what makes NOLHGA such a dynamic organization is that we are made up of so many vital entities." Over the past several years, he said, these groups have worked together so well that "the skill level of the guaranty system has made excellence seem commonplace."

McMahon also praised NOLHGA and its members for not resting on their laurels during periods of relative inactivity. "We've used the downtime between insolvencies to hone our skills and prepare ourselves for the next crisis," he said, noting that the past year has seen a great deal of work on major insolvency preparedness, as well as the efforts of the Financial Services Modernization Committee to educate Congress and the administration on the guaranty association system.

This kind of work is vital, McMahon explained, because the next major insolvency "may be a 'make or break' moment" for the system, with Congress and opponents of the current guaranty system watching closely to see if NOLHGA and the guaranty associations falter in any way. McMahon expressed great confidence in the system's ability to meet any and all challenges, saying that his year as chairman "has only deepened my belief in the strength and value of our guaranty system and increased my admiration for the people who make it work."

Potter echoed McMahon's comments in his address, praising the "core of experienced, highly skilled professionals who have been through the 'dark days' of the early 1990s and lived to tell the tale." The expertise possessed by this group "is like gold for our organization," he said, and has helped put NOLHGA in the best shape he's seen in his 12 years in the guaranty association system.

Potter called on NOLHGA to continue its crucial work of resolving insolvencies while embracing a new role "as a resource and repository for insolvency-related materials and information." This new role, he explained, is called for in part because of the move toward an optional federal charter, and NOLHGA is already acting as an information resource in that arena with its congressional education effort.

NOLHGA's role as an information resource is not limited to optional federal chartering, however. Potter noted that the organization's goal must be "to amass insolvency information and put it at the disposal of the people who need it most—our member associations and the people with whom they work." This is accomplished by what Potter called "NOLHGA's trade association activities," such as the educational effort mentioned earlier, the NOLHGA Web site, and special reports such as *The Nation's Safety Net*, a report on guaranty association benefit levels that was distributed at the meeting.

Over There

By Larry Henry

The NOLHGA Web site's Press Room (at www.nolhga.com) provides the latest news concerning the state of the life and health insurance industry. In each issue of the NOLHGA Journal, *we will examine the issues shaping the insurance landscape.*

Earlier this year, in its annual assessment of the trends affecting the U.S. life insurance industry, A.M. Best stated that "extreme volatility in the equity markets and low interest rates create significant challenges in managing the top and bottom lines" for insurance companies. A scan of the year's headlines indicates that such has been the case. It also indicates that U.S. insurers have much in common with their colleagues overseas.

From the East to the West, factors similar to those impacting the U.S. market have taken their toll on the international life insurance markets as well. Recent articles on the state of both the Japanese and European insurance sectors make clear that exposure to the equity markets and falling interest rates have hit both markets.

The Land of Rising Concerns

The economic environment in Japan has been particularly inhospitable to its life insurers. Standard & Poor's recently stated that the Japanese life insurance market "faces further consolidation as slumping stocks, shrinking policy numbers and low investment returns weigh on earnings."

Low interest rates have proven to be a critical factor in the downturn. According to AFX News Limited, "a large number of policies with high guaranteed returns sold during the asset-inflated era of the bubble economy remain in force, and the bearish stock market has put life insurers in a financial bind."

The *Agence France-Presse* reported recently that "Japanese life insurers are struggling under negative spreads, where rock-bottom interest rates and returns on investments have fallen below yields guaranteed to policy holders." To counter this threat, Japan's Financial Services Agency (FSA) announced plans to allow insurers to cut investment returns guaranteed to policyholders. In its attempt to stem the tide of negative spreads, "the FSA aims to avert the collapse of life insurers," the *Agence France-Presse* reported.

The same article noted that concurrent with the allowed cut in guarantees, the FSA would also "ban policy cancellations for a certain period as it is worried the cut would trigger massive cancellations from policy holders." The contemplation of moratoria demonstrates the gravity of the situation—according to a recent article in *Nihon Keizai* (a Japanese newspaper) cited in the AFX News Limited article, life insurers are earning negative spreads on "over 70 percent of individual life policies and pensions."

> *From the East to the West, factors similar to those impacting the U.S. market have taken their toll on the international life insurance markets as well.*

The Japanese daily *Kyodo News* summed up the situation in a recent article, noting, "the business environment surrounding Japan's life insurance companies is very severe, and some insurers may be forced out of the market."

One way a company could be "forced out" is by liquidation. A November 22, 2002, *Kyodo News* article discussed the concerns of U.S. insurers over the pending expiration of the Life Insurance Policyholders Protection Corporation of Japan (PPC), which was "set up in 1998 by all life insurers to protect policyholders in the event of a member's failure." According to the article, the PPC "has almost run out of funds due to a spate of collapses in recent years," and U.S. officials have urged the Japanese to add to and extend the funding of the PPC.

Not So Merry

The UK life insurance market has also seen its share of troubles. AFX News Limited reported recently that Moody's Investor Services has placed the ratings of most UK life insurance companies under review for possible downgrade. Moody's cited "the impact of the depressed equity markets on the companies' capital strength and financial flexibility."

An A.M. Best report by David Pilla on November 4, 2002, stated that the UK insurance industry has been hit by a confluence of events, noting that "weak equity markets…a spate of resignations of high-level executives…and A.M. Best downgrades have added a sense of urgency to an industry in transition, capped by rapidly changing regulatory rules."

As in Japan (and here in the United States), the slumping equity markets appear to be the driving force behind the sector's difficulties. In addition, Pilla pointed out, "as declining equity markets eroded life insurers' assets over the past year, regulatory changes—already planned—took on a new urgency." These regulatory changes include more stringent financial reporting requirements and revamped solvency rules.

Concerns on the Continent

There have also been a number of articles chronicling the troubles of Swiss and German insurers. A.M. Best recently reported on a Goldman Sachs & Company study predicting that "falling stock prices, negative interest-rate developments and accounting changes are likely to squeeze smaller players out of the German life insurance market."

Sound familiar?

But it's not only the small companies that are in trouble overseas. Allianz AG recently raised two billion euros in its efforts to shore up its solvency position and pacify analysts. One major concern over this move is that the debt issue is meant, in part, to satisfy solvency requirements for both its insurance companies and its recently acquired banking division.

In Switzerland, Swiss Life has had to restate its financials twice this year and is also looking to issue over a billion euros in debt to bolster its balance sheet. Concerns over the company's possible financial chicanery reached serious proportions, according to *The Guardian* (UK): "The chief executive of troubled insurance group Swiss Life has been ousted in a boardroom coup as investigators examine an investment fund which provided huge profits for top managers."

Far Away, but Close to Home

Without a doubt, the troubles faced by the life insurance industries in Japan and Europe are a product of the particular economic environment in each region. But there is also little doubt that the problems that plague Asia and Europe bear a strong resemblance to those affecting the United States—weak equity markets, low interest rates, and a heightened scrutiny of financial reporting and management behavior.

It remains to be seen whether the U.S. insurance industry is heading in a direction similar to that of its Japanese and European counterparts—whether we are headed, as the song says, "over there." It's also unclear whether signs of a recovery will first surface here in the United States or abroad. The one thing that is clear is that, in the meantime, articles about troubles in the life insurance industry are equally at home in newspapers and periodicals both in the United States and overseas. ■

Larry Henry is manager of insurance services for NOLHGA.

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tem for all insurers. "I think the worst scenario is separate systems," he said, pointing to a decline in assessment capacity, potential difficulties with different protections offered by the dual systems, and the likelihood of flight to the federal system. "Other things being equal," Harrington said, "policyholders will lean toward federally guaranteed insurers."

Harrington praised the effectiveness of the current state-based guaranty association system, but he added that "a universal federal guaranty system may well be inevitable with optional federal chartering." This new system would most likely be based on the pre-funded FDIC model, which Harrington believes is less beneficial to policyholders than the current post-funded system.

The best way to avoid an FDIC-style system, Harrington added, is simple: "Don't go down the road to optional federal chartering." He pointed to speed to market as a key factor in reforming the state-based regulatory system and forestalling a federal charter. "If the states can do enough on speed to market," he said, "I don't think federal chartering is inevitable."

The Perfect Storm

Elizabeth Malone, managing director of research for Advest, Inc., spoke on what she called the "perfect storm" of factors affecting the financial health of the life insurance market. She pointed to the drop in investment performance across the board and noted that "the volatility in the market caught many by surprise." Malone cited hedge funds and investors' almost-instantaneous access to information as two of the forces driving this volatility. She also predicted continued volatility, at least in the short term, thanks in part to the continuing demands for increased transparency and detail in companies' financial statements.

With the recent troubles of some well-known insurance companies, Malone also predicted another round of what she called "savior CEOs" brought in to turn companies around. "They love to come in and run insurance companies," Malone said, and companies are willing to pay them quite a bit to do so. However, Malone cautioned that there's a significant risk involved in bringing in CEOs from outside the insurance industry. Traditional turnaround plans are sometimes ill suited for the industry, she explained, and the new CEOs "don't understand that this isn't Ford."

Malone closed her presentation by noting that the increased oversight and disclosure the market faces will help in the long run by making it more difficult for businesses to become involved in high-risk projects. She predicted a rebound for the stock market, although she also predicted more "sell" recommendations from stock analysts. Analysts have come under fire for being "too cozy" with the companies they're evaluating, Malone said, "and it's forced them to take a more jaundiced eye" in making recommendations.

HMO Regulation

Holly Bakke, commissioner of the N.J. Department of Banking and Insurance, gave meeting attendees an inside look at HMO solvency regulation and the difficulty in deciding when to step in and declare a company insolvent. She noted that feedback from consumers often helps her department target problem areas for specific companies. "We find that we focus on being a consumer-oriented department," she said.

Bakke added that one of the challenges her department faces in regulating HMOs is the need to work with other regulators, such as the Department of Health and Senior Services and the Department of Human Services. "We used to do things in a vacuum," she explained. "We've had to reach out to other agencies" to ensure that they speak with one voice when dealing with a particular company. ■

Sean M. McKenna is the communications manager for NOLHGA.

Calendar

2003		
February 11–12	**NOLHGA Board Meeting**	**Dallas, Tex.**
February 17–19	**NOLHGA MPC Meeting**	**New Orleans, La.**
March 8–12	NAIC Spring National Meeting	Atlanta, Ga.
May 7–8	**NOLHGA Board Meeting**	**Location TBD**
May 7–9	NCIGF Annual Meeting	New Orleans, La.
May 19–21	**NOLHGA MPC Meeting**	**Salt Lake City, Utah**
June 21–25	NAIC Summer National Meeting	New York, N.Y.
July 24–25	NCIGF Legal Seminar	Jackson Hole, Wyo.
August 6–7	**NOLHGA Board Meeting**	**Location TBD**
August 19–22	**NOLHGA 12th Annual Legal Seminar/MPC Meeting**	**San Francisco, Calif.**
September 13–17	NAIC Fall National Meeting	Chicago, Ill.
October 27–29	**NOLHGA 20th Annual Meeting**	**Dallas, Tex.**
November 13–14	NCIGF Workshop	Savannah, Ga.

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