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Where State & Federal Meet

Missouri Director John Huff discusses his service on the FSOC and the strengths of state regulation

John Huff is the Director of the Missouri Department of Insurance. In September 2010, he was appointed to the U.S. Financial Stability Oversight Council by the National Association of Insurance Commissioners. He is the only insurance regulator on the council, which was created by the recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act. The council is charged with coordinating the nation's financial regulators to identify systemic risk to America's financial stability.

Director Huff will be speaking at NOLHGA's 2011 Annual Meeting in October. He spoke with the ***NOLHGA Journal*** *in August.*

NJ: *I understand you participated in the relief efforts after the Joplin tornado. Could you describe what that was like and discuss the ongoing efforts to help the Joplin residents?*

Huff: It's important for us to keep it in perspective, at least in the Insurance Department, because this will be the largest insurance event in Missouri history. The only way to describe it is just utter devastation—six miles long and a mile deep. When you see a national television meteorologist break down in tears, you get a sense of the impact on the community. The photographs just don't do it justice. And the loss of life—159 lives—it's the largest death count in a tornado in the last six decades in the United States.

When you see it, it's just so hard to believe that there weren't thousands of deaths from the devastation. These are people we know. These are our friends, our neighbors. We're very protective, and we want to be helpful to them in their recovery process.

So, one of the first things we did was to send a very strong message that we did not want the scam artists coming from across the country to prey on people at

["State & Federal..." continues on page 16]

We'll See You in Chicago!

Don't miss out on Director Huff and the other speakers at NOLHGA's 2011 Annual Meeting in Chicago this October. To learn more about the meeting or to register, visit www.nolhga.com/2011AnnualMeeting.cfm.

28th nolhga annual meeting
October 11–12, 2011 | Chicago, IL

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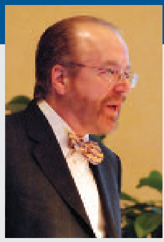


President's Column by Peter G. Gallanis

What to Do While Waiting for the New Normal

I keep hoping for the day when I'll be able to start a column by writing that the economic and political landscape has returned to what it was before the financial crisis began in late 2007. Today is not that day, and this will not be that column.

The Depressing Headlines

I am finishing this column in the immediate wake of the Washington debate over the debt ceiling and a near-default on U.S. government obligations. That debate involved proposals for a "grand bargain" on long-term debt reduction coupled with tax reform. The grand bargain proposals ultimately failed. The dispute was resolved by a short-term increase in the debt ceiling combined with relatively modest spending reductions and the creation of a congressional "super-committee." The super-committee is charged with crafting a more comprehensive deal later this year to avoid automatic triggers thought harmful to both political parties.

It remains to be seen how much the super-committee will accomplish, given the "third rail" problems faced by each side: Some Democratic leaders are pledging that no cuts will be made to any entitlement programs, while all the Republican presidential candidates are pledging to oppose any revenue increases, regardless of how much spending reduction may be achieved in exchange.

Notwithstanding the early August compromise, Standard & Poor's downgraded its rating of U.S. debt (though rivals Moody's and Fitch did not), and the last two weeks were the most volatile on record for the U.S. equities market. Meanwhile, economic indicators declined in the United States and even more so in Europe.

All of this left the more optimistic economic pundits wondering whether prosperity might still be just around the corner, while others have asserted that the current chaotic state of the economy is the "new normal," with a new recession about to succeed one that feels as though it never ended.

And as these developments unfolded, the guaranty system continued to plan and prepare for the possibility of a couple of insurer liquidations likely to receive significant public attention, even though neither company is remotely "systemically important."

Specific Concerns

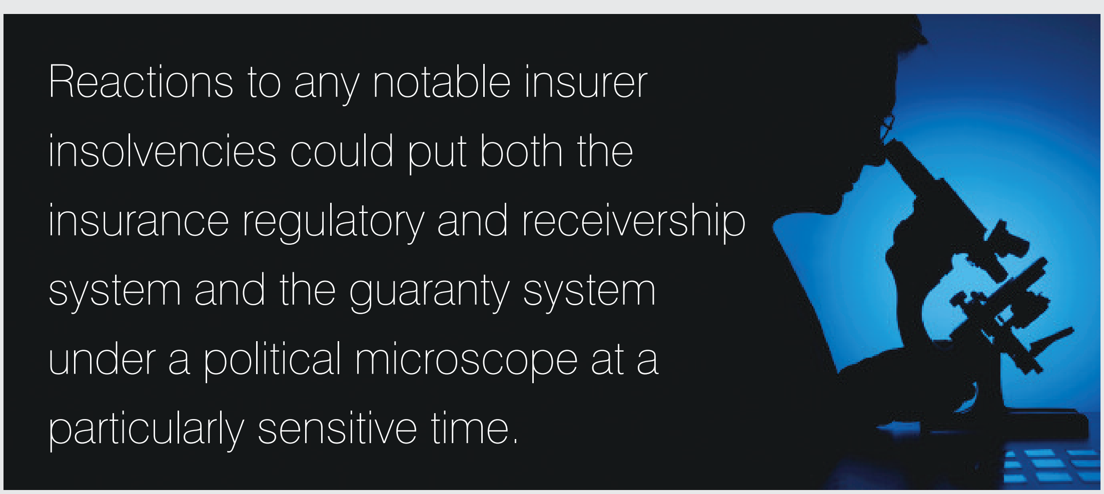
If this is the new normal, it bears little relationship to the normalcy we knew before the crisis began. The meaning for those of us concerned with the insurance industry and protecting consumers against insurer insolvency flows from several issues.

First and foremost, this economy remains fragile. It will be hard for insurers and their customers to thrive without a meaningful recovery, and an extended recession doubtless will push at least a few marginal insurers over the brink.

Second, a full-blown rewrite of the tax code—one option before the super-committee—could put in play some tax treatments material to life industry economics.

Third, continuing uncertainties about the implementation of the Dodd-Frank Act and PPACA mean that both the life and health insurance sectors continue to operate under significant regulatory clouds.

Fourth, reactions to any notable insurer insolvencies could put both the insurance regulatory and receivership system and the guaranty system under a political microscope at a particularly sensitive time. In just a few months, the new Federal Insurance Office (FIO) and its recently appointed Director, former Illinois Insurance Director Mike McRaith, are due to release a comprehensive analysis and evaluation of current insurance regulation—with some specific charges to review receivership and guaranty system issues.



While insurance regulators, receivers, and guaranty associations plainly aren't out of the woods yet, the experience of managing through several insolvencies and near-insolvencies since the start of the crisis suggests some lessons about how we should be planning and managing our affairs as we wait for whatever normal eventually emerges—new or old.

The Three Cs

The first lesson is essential, but no longer new: As the NAIC concluded in its famous White Paper several years ago, communication, coordination, and cooperation among regulators, receivers, and guaranty associations are more critical now than they've ever before been.

As receivers Dan Watkins, David Wilson, and Pat Hughes all observed at the 2011 NOLHGA Legal Seminar, recent experience proves that the chances of a successful outcome in a troubled company situation increase when the guaranty system is engaged by regulators early in the troubled company process—sometimes even before regulatory intervention takes place.

Receiverships of life and annuity writers are relatively rare, and even some major states have little or no experience with the special challenges of such receiverships, whereas NOLHGA's members have been involved in *every* receivership of life and annuity writers dating back to the early 1980s. We stand ready, willing, and able to share our experience and resources with regulators and receivers: A favorable outcome for the consumers we all protect is in everyone's interest and must trump all concerns over "turf."

Prompt and Effective Corrective Action

The second lesson—which has become painfully clear—is that prompt, decisive regulatory action when a company becomes materially insolvent is crucial. There aren't many paths that can lead a significantly insolvent company back to solvency, and prior efforts to achieve such a near-miracle usually have demonstrated the illusory triumph of hope over experience. On the other hand, prompt and decisive regulatory action in the failures of writers of life and annuity business usually produces full or nearly full recoveries of consumers' account values, even for contracts exceeding guaranty association limits.

It's hard for everyone involved, especially the domiciliary regulator, to conclude that a company must be liquidated. However, it can be devastating for everyone—especially consumers with accounts exceeding guaranty association limits—to pretend that a company can be saved when that pretense is based on little more than wishful thinking.

The creation of the NAIC's new "R-FAWG" group is a sure sign of the growing recognition of the value of prompt, effective regulatory intervention (known as "prompt corrective action" in the banking world). R-FAWG (chaired by Iowa Chief Deputy Commissioner Jim Mumford) has as its goal providing the same sort of receivership peer review and support process for receiverships as has been utilized for years—through the NAIC's FAWG (Financial Analysis Working Group) process—in the financial supervision of troubled companies. This is a bold move by the NAIC that should be applauded. The receivership of a company is no more the private preserve of the domiciliary regulator than is the financial supervision of that company. Extraterritorial effects abound in both cases. Thus, a multistate peer review process is appropriate in both cases.

Planning for Mega-Cases

Third, if "the three Cs" have proven indispensable in ordinary insurer receiverships, something even more needs to be done to provide and plan for the failure of a systemically important financial institution (SIFI) that would trigger the "orderly liquidation authority" provisions under the Dodd-Frank Act (DFA). As most *Journal* readers know, DFA leaves responsibility for protecting insurance consumers where it has been—with state regulators, receivers, and guaranty associations—when a failing SIFI has one or more insurers in the overall holding company structure.

That said, the FDIC is charged with overseeing the orderly liquidation of the holding company and its non-insurer subsidiaries. Even in the best case, that cannot be done without extensive coordination between the FDIC, as SIFI liquidator, and the state regulators, receivers, and guaranty associations involved with subsidiary or affiliated insurers. To that end, guaranty system representatives have been working closely with members of the NAIC's new Dodd-Frank Receivership Implementation Working Group (DRIWG), chaired by Illinois Special Deputy Receiver Pat Hughes, to develop plans and procedures that might be used to optimize the outcome for insurance consumers in such a SIFI liquidation.

Planning, Planning, and Planning

Fourth and finally, being prepared and having plans, tools, and resources identified in advance is critical for *any* complex receivership—not just a DFA orderly liquidation. It's never too early to plan for a complex case, and it's never too late to reexamine and refine a plan that is shown by experience to need new or different components. Planning for a complex case is a multidisciplinary exercise that requires consideration of (among others) financial, operational, investment, administrative, and communications elements. Our goal in every case should be to enter the case as well-prepared as we can be, and to end the case with a view to adding any new lessons learned to our core insolvency guidelines "playbook."

In conclusion, the uncertain economic and political environment of the past few years continues, and no one can say what implications that environment may have for insurer insolvencies in the near future. We do know this, though: The performance of our system and its leaders—regulators, receivers, and the guaranty associations—will be closely watched in any high-profile receiverships that may emerge. The best way to survive and thrive through such cases and the attendant scrutiny will be to work together as a team to deliver the best possible outcome for the insurance consumers who depend upon us all. ✯

Peter G. Gallanis is President of NOLHGA.

San Francisco Story

NOLHGA's Legal Seminar weaves a tale of cyborgs, SIFIs, and more

By Sean M. McKenna

The official theme of NOLHGA's 2011 Legal Seminar was "On the Right Track," but over the course of the two-day meeting, it became clear that the thread running through much of the program was storytelling. New York Life's Ted Mathas said the insurance industry has "a phenomenal story to tell" about everything it does for its customers. "We've got a terrific story to tell as guaranty associations," said Protective Life's Deborah Long. And Randy Blumer (Wisconsin Insurance Security Fund) asserted that "we have a pretty damn good story to tell" about how the insurance industry weathered the financial crisis.

More than 175 people came to San Francisco in July to hear those and other stories. They left with insights into the changing face of financial services regulation, the best ways to resolve insolvencies, what to expect as (or if) health-care reform picks up steam , and other pressing issues facing the industry and the guaranty system. And since the meeting was held in the always-interesting city of San Francisco, they probably left with a few stories of their own.

Friendships & Receiverships

"Early and close collaboration is the goal. It leads to more productive, civil, and constructive discussions." This comment by Daniel Watkins (The Law Offices of Daniel L. Watkins) referred not to the NFL lockout that was in full swing this summer, but instead to the value of early involvement of the guaranty associations in a receivership. In *A Beautiful Friendship: Constructive Guaranty Association/Receiver Interactions*, a panel discussion moderated by Scott Kosnoff (Baker & Daniels), Watkins, who has served as receiver for many companies, stressed that sharing information with the affected associations was the best way to build trust and confidence in each other, which proves especially valuable when tough decisions have to be made. Jim Mumford (Iowa Insurance Division) agreed and added that "we have to cooperate" to keep the state regulatory system intact.

Talk turned to the NAIC's Financial Analysis Working Group (FAWG), which acts as an "early warning system" for troubled companies. Blumer, who headed FAWG during his tenure with the Wisconsin Office of the Commissioner of Insurance, said that "early detection is critical" but emphasized that the review process, in which insurance regulators question their colleagues about troubled companies in their state, can be rigorous—a notion seconded by others on the panel who have been on the receiving end of those questions.

The FAWG process ends when a company is placed in receivership, but the NAIC recently created R-FAWG, importing the FAWG framework into a new review of the handling of receiverships. Patrick Hughes (Illinois Office of the Special Deputy Receiver) predicted that R-FAWG will soon be viewed "like air conditioning—once it's invented, you wonder how you lived without it. It's going to pay dividends down the road." Watkins remarked that the R-FAWG process of bringing in the expertise of a number of regulators "sounds a little bit like a NOLHGA task force on the regulatory side." Mumford seconded that and talked convincingly about the developing template for cooperation among receivers and guaranty associations to protect policyholders.

The panel on receiver/guaranty association interactions discussed the value of early intervention, the NAIC's new R-FAWG process, and other ways to improve receiverships.

R-FAWG is designed to improve the efficiency of the receivership process, and one driving force behind this effort is the Dodd-Frank Act and the possibility of state regulators working with the federal government to deal with a troubled company that is deemed a systemically important financial institution (SIFI). If this occurs, Hughes said, "We have one chance to get it right."

It's probably no coincidence that the seminar also featured a panel on the best ways to handle receiverships. *Preparing for a Domestic Insolvency*, a panel moderated by Joel Glover (Rothgerber Johnson & Lyons LLP), brought together key players in the receivership process—including Watkins—to discuss best practices in dealing with a company facing liquidation.

All the participants agreed that early guaranty association involvement is key. "First of all, it's free

advice," said Danny Saenz (Texas Department of Insurance), but the benefits flow both ways. "The reputational risk for guaranty associations is fairly high" if a receivership goes badly.

When guaranty associations are brought in to consult on a troubled company, "The first thing we think about is our obligation to policyholders and continuing coverage," said Jackie Rixen (Law Office of Jacqueline Rixen), who serves as legal counsel for the Texas guaranty association. The associations have a laundry list of factors to consider—licensing, policy forms, administration of the company, and over-limit policy amounts, to name just a few—and the earlier they can start their work, the better.

Watkins noted that early involvement also applies to the regulators themselves. "The regulatory community has gotten better at identifying trouble further upstream," he said, which has good and bad effects. "You see trends coming, but it's not a slam dunk," he added, and companies will fight to stay out of receivership.

In response to the question of whether liquidation is considered a failure by some regulators, David Wilson (California Conservation and Liquidation Office) replied, "Liquidation is easy, to be honest. Everything is fixed, and the statute is clear." The downside comes if policyholders will see a large reduction in benefits when liquidation is declared. "That's going to be a horrible mess," he added.

A SIFI Proposition

Legal Seminar planners chose wisely when they selected Charles Richardson (Baker & Daniels) to moderate the *Dancing with the Federal Stars* panel discussion on financial services regulatory reform and how it will affect the insurance industry. Who else could say, "We are well into the second century of debate over who regulates insurance," and then follow it up with "The next six months will be key."

Richardson also quoted a well-known writer, stating that "The financial crisis battlefield was littered with the corpses of financial services companies, but none of them were insurance companies." Gary Cohen (Sidley Austin, LLP) surveyed that battlefield as part of his role as General Counsel of the Financial Crisis Inquiry Commission (FCIC), and he

Health-Care Reform, California Style

In his remarks at the 2011 Legal Seminar, California Insurance Commissioner Dave Jones said that implementing the Affordable Care Act of 2010 was "one of my top priorities," noting that the department established the 80% Medical Loss Ratio (MLR) standard the day he was inaugurated. The department has moved quickly to put in place other aspects of the Act—California is establishing a health benefit exchange, and the department issued new regulations prohibiting insurance companies from denying insurance to children with preexisting conditions—and Commissioner Jones said that "We like to consider ourselves the pace car" when it comes to implementation.

Commissioner Jones warned that there were a number of challenges facing his department, and the country, in any efforts to put the Act into action. "There are a lot of chefs in this kitchen," he said of the need to coordinate state and federal regulation. "We need to make sure everyone is talking to each other." He also warned of the possible effects of the budget crunch that California and most other states are facing, and the cuts in services that have resulted from it. "We're essentially cutting the health-care safety net here in California as we're expanding it," he said, adding that almost six million people were entering the insurance rolls in his state.

explained that the three Republican members of the commission who publicly dissented from the conclusions in the commission's report did so only after their party had retaken the House and was in a position to attempt to de-fund some aspects of the Dodd-Frank Act. He added that the commission's work confirmed that "We were on the brink of financial Armageddon in September 2008. We're not out of it yet," he added, but the main players at that time saved the financial system.

Cohen had decidedly mixed feelings about the Dodd-Frank Act. "Dodd-Frank was rushed through Congress before our commission had done its work," he explained, noting that some parts of the Act have nothing to do with the financial crisis. "It's imperfect, but it was necessary for Congress to pass a bill when they had the chance."

Alessandro Iuppa (Zurich Financial Services Group) set the global scene for attendees, explaining that the European market shares the United States's concerns with reforming supervisory structures and the "too big to fail" SIFIs. He noted that the Financial Stability Oversight Council (FSOC) is a "body of concern for market participants," who fear that it will trigger "more intrusive and invasive regulation" of SIFIs.

Europe is also about a decade into work on the Solvency II initiative to make solvency regulation more uniform across the European Union. That initiative will be felt on this side of the Atlantic as well, Iuppa said, with many U.S. companies concerned about equivalence. There's no guarantee that the insurance regulation in the United States will be deemed equivalent to the Solvency II scheme (which would allow U.S. companies to write business in the EU). The United States was not included in the first wave of equivalency assessments.

Much of the focus in the United States has been on which companies will be named SIFIs and the concept of systemic risk. In his presentation on the topic, Professor Scott Harrington (The University of Pennsylvania Wharton School) said that "We all know what systemic risk is, but we're grateful when no one asks us to define it." He defined it anyway, as "a large, system-wide shock that affects multiple players." He also noted that "Systemic risk is low in life insurance compared with banking."

That being the case, he added, it would make sense not to designate any insurance companies (except AIG) as SIFIs, but "There's enormous pressure to rope in at least one or two insurance entities." Professor Harrington, who has qualms about the entire SIFI concept, believes this would be a mistake. In fact, he doesn't support federal regulation of insurance at all—he fears it could lead to "broad intervention in insurance pricing" as well as artificially high capital requirements for an industry that has shown enough market discipline not to need them.

The benefit caps in the guaranty system "help maintain this market discipline," Professor Harrington explained, by forcing policyholders to consider the financial strength of companies. "It's important to avoid any significant expansion in insurance guarantees," he added, to stave off increased moral hazard.

"If you have a cell phone, you're a cyborg," said "Cyborg Anthropologist" Amber Case, who entertained attendees with her insights into how humans use technology and its growing importance—or indispensability—in our lives.

What, Me Worry?

Hazards of another sort were on the minds of the participants in the panel *General Counsel Perspectives: What Keeps Us Up at Night*, moderated by Kevin Griffith (Baker & Daniels). Though the panelists came from very different companies, they all agreed with Deborah Long (Protective Life Corporation) that the first rule in any legal department is this: "Don't surprise your General Counsel."

Long commented that one of the great challenges General Counsel face is the passage of time. "We're going to be judged by changing standards," she said, explaining that the expectations of consumers can change over 40 years, even if their policies haven't. "As a General Counsel, I just want to know what the rules are."

Nick Latrenta (MetLife, Inc.) noted that "It's difficult to look back at something you did in 1943 through the lens of 2011." He added that the systems in place at companies were different in the past, and it's "devilishly difficult" to adapt them to modern expectations and standards.

As the topic turned to the guaranty system, Susan Blount (Prudential Financial, Inc.) noted that a variety of forces—from the Dodd-Frank Act to large receiverships—have the potential to focus the industry's attention on the guaranty system. "Shame on us if we don't take this opportunity to really take stock," she said. "Let's start wrestling these issues to the ground. Otherwise, they'll be 'solved' for us." Latrenta pointed to a lack of uniformity and the need to pin down the coverage implications of new products as two issues that are of key importance for the system.

A number of issues of key importance were addressed in the presentation *Hot Topics in Insurance Litigation* by Steuart Thomsen (Sutherland Asbill & Brennan LLP), including the growing number of retained-asset account (RAA) suits. "The results for insurance companies have been mixed to date," Thomsen said. "A number of judges seem to have a visceral reaction to companies retaining assets." Not surprisingly, he predicted more suits will be filed.

He made the same prediction concerning unclaimed property suits. Dozens of companies are being audited because of this, and the New York Department of Insurance recently directed insurers to check the Social Security Death Master File on a regular basis for the names of life, annuity, and RAA policyholders. NCOIL is considering a bill along the same lines.

"It's not surprising that the plaintiffs' class-action bar is not far behind" on this issue, Thomsen said, "but they are going to face some hurdles in bringing these as class actions." Those hurdles include establishing the legal basis for threshold "commonality" requirements, lack of injury, variations in state law, and (last but not least) inclusion of dead people in the class.

No discussion of litigation would be complete without mentioning the *Annual Guaranty Association Legal Roundup* presented by William O'Sullivan (NOLHGA) and Tad Rhodes (Oklahoma guaranty association), affectionately known as "Bill & Tad's Excellent Adventure." The roundup touched on issues including RAAs, attempts by the federal government to overturn the receivership priority rules ("Any creditor who steps before us in the priority scheme is going to reduce our access" Rhodes said of two cases seeking to overturn the *Fabe* preemption exclusion), and states adopting the new GA Model Act. "We need to look at this as a question of when, not if," O'Sullivan said, noting that 23 states have already enacted the new law.

Health & Taxes

When it comes to the Patient Protection and Affordable Care Act (also known as ObamaCare, depending on what side of the political spectrum you inhabit), both "if" and "when" apply. Much of the law isn't scheduled to take effect for years, and the push to repeal or de-fund the law before implementation occurs was a key theme in the 2010 congressional elections.

In *A 360 Degree Review of Health Care/Insurance Reform*, moderator Randy Kammer (formerly of BCBS of Florida) said that the early stages of the law's implementation have been a little rocky. The future could be tough sledding as well—Kammer cited a number of facets of the law that could affect the guaranty associations. An excise tax on insurance companies of approximately $8 billion in 2014 could, obviously, have solvency implications for some companies. "This is the next thing guaranty associations need to worry about," she said. Another cause for worry, she added, is the lawsuit joined by 21 states to repeal the individual mandate in the Affordable Care Act, since the suit doesn't touch on the requirement that companies accept people with preexisting conditions. That requirement, if not coupled with the individual mandate, could keep the guaranty associations quite busy.

Gary Cohen (Center for Consumer Information and Insurance Oversight, which is charged with implementing many provisions of the Affordable Care Act) acknowledged that "there's concern about how big players in the market will react" to factors such as new regulations, the 80% Medical Loss Ratio (MLR) standard, and rate review from federal and state governments. He noted that the federal government is intent on collaborating with the states, with the NAIC taking the lead in many facets of the Act's implementation. Even with the Act's mandate that the Health and Human Services Secretary monitor the states' rate review processes, he said, "The program we developed gives the greatest possible deference to the states." At least 40 states will continue to perform their own reviews, and he expects more states to meet the effectiveness criteria in the future.

On the MLR front, Cohen noted that, in many cases, carriers are well above the standards set forth in the Act, although he added that companies in the individual market are often below the MLR standard. States can apply for an adjustment to the standard, and three adjustments have been granted so far. In closing, he expressed confidence that the health-care market is on sound footing, explaining that the financial health of the major players "is extremely strong."

Dr. John Maa (University of California San Francisco Medical Center) expressed extreme skepticism about the Affordable Care Act's ability to turn around a floundering health-care system. "Many physicians remain doubtful that the methodology of reform will succeed," he said, because there is no major cost-cutting component in the Act. He added that most doctors agree that "the current delivery system is doomed."

Dr. Maa praised the effort to make health insurance available to everyone, but he noted that "the insurance industry has been cast as a villain" in most narratives, with the result that the role the industry plays in combating cost increases and over-treatment is forgotten. Consumers, he added, need to educate themselves so they can "bend the price curve through greater transparency," while all parties in the process need to "be more intelligent about how our health-care dollars are spent."

Bruce Pyenson (Milliman) began his presentation by saying that "My thesis is that the Affordable Care Act is actually creating more risks" for consumers and the industry. The Act, he said, creates the possibility that employers will drop coverage and force

Randy Kammer led a spirited discussion on the Affordable Care Act and its likely effects on the health-care industry.

their employees into the planned insurance exchanges. "That's a new risk," he said, and it's not the only one.

Pyenson cited regulatory upheaval, adverse selection, and underwriting as other risks the market will face as a result of the Affordable Care Act. "I think the timing of cash flow becomes a big risk as well," he said, as does the threat of regulators focusing solely on implementing the Act. "Most regulators aren't thinking about solvency," he said.

It's a safe bet that most attendees weren't thinking about the tax code before Walter Welsh (ACLI) began his presentation, but he quickly took care of that. "We have special tax treatment for all of our products" in the life insurance industry, he explained, "and tax reform is one of the big pressures we're facing."

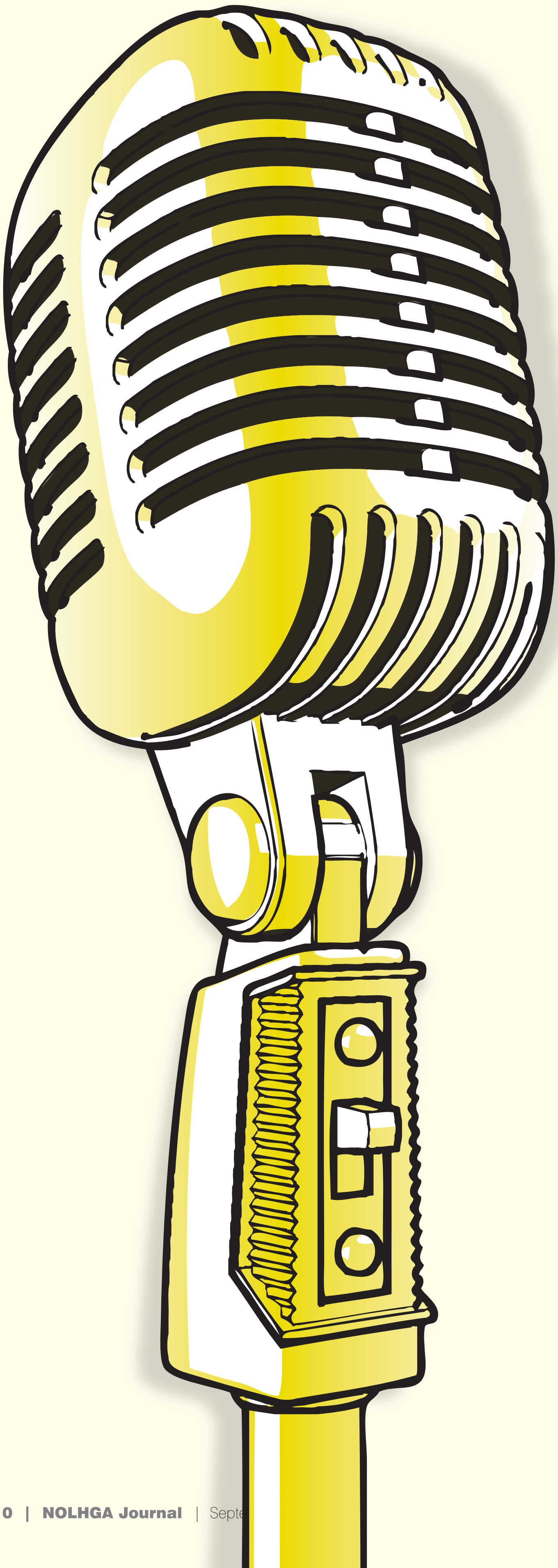
The focus on cutting the deficit has many on Capitol Hill going over the tax code with a fine-toothed comb, Welsh said. And while tax increases are unlikely, reducing or eliminating billions of dollars in tax deductions—like those that apply to insurance products—is being considered as a revenue booster.

The ACLI is fighting to maintain the current treatment of the industry's products (go to www.securefamily.org to see how), and Welsh said that "fundamental tax reform is not likely to happen in 2011. The real issue should come in 2013," after the presidential election.

In other words, the story's not over yet. ✮

Sean M. McKenna is NOLHGA's Director of Communications.

All photos by Kenneth L. Bullock.



"People Need What We Have to Offer"

New York Life's Ted Mathas sits down with NOLHGA President Peter Gallanis to discuss the life insurance market, the guaranty system, and the risks and rewards of being systemically important

The following is an edited transcript of my Legal Seminar interview with Ted Mathas, the Chairman, CEO, and President of one of the leading financial institutions in the world, New York Life. The interview took place on July 22, 2011.

Peter G. Gallanis

GALLANIS: *The old line is that life insurance isn't bought, it's sold. And there are a lot of people out there who don't know very much about life insurance. How do you explain, and how do you expect the people in your company to explain, the value proposition behind traditional life and annuity products?*

MATHAS: I think we have a phenomenal story to tell, in particular now with what's going on in the world. Life insurance and annuities—they're not fads. They're products that have stood the test of time. They provide real, substantial value to people in their lives. Take the expression you used, "life insurance is sold, not bought."

A lot of people think that means you have to have some kind of a pushy salesperson getting you to do something that you wouldn't otherwise do, and they say, "Oh, that's a bad thing." No, no. Getting people to do what's in their best interest isn't a bad thing. Think about how hard we work as a society to get people to just do the right thing, whether it's eating right or living healthy lives. We need powerful incentives. Why do people hire personal trainers? Because they figure out, "I can't do it on my own."

So fundamentally to me, that's nothing to be embarrassed about. I think so much of our business is about understanding people, and that's what I think our best agents do— understand people. And so much of our value proposition is about that, and yet we get all these attacks from the outside. "Buy term and invest the difference" is a perfect example. There's nothing wrong with term insurance. We sell a ton of term insurance.

Term insurance is probably a great place for most people to start. I personally believe over time most people should own both term and permanent insurance, because they serve different roles in your portfolio. But the concept of "buy term and invest the difference" was, as we all know, thrown out a long time ago. It's this idea of trying to invalidate the role of permanent cash value life insurance. The problem with that is it doesn't speak to any of the advantages of permanent cash value life insurance…and there are real advantages.

Also, people don't invest the difference. They spend it. And that's why we have our people sit down with people and try to explain. What most of our agents do is get people to focus on priorities. Do you know what our single greatest competition is for most of the business that we do? Big screen TVs and vacations. It's not somebody else's product.

Most of the time, when our agents sit down with someone, they have a person who says, "What matters most to me is my family and making sure my family is taken care of." And when you ask, "How come you don't own any life insurance?", they say they can't afford it. Well, if you have a big screen TV, if you're planning a nice vacation, you probably can afford it. It's a choice, a prioritization.

You can say that was sold to somebody, or you can say you got people to actually prioritize what they themselves are saying and act upon those priorities. So I feel this is an area where we should not be defensive. We have an unbelievable story to tell. End of the day, people need what we have to offer, which is financial security, trust, and advice. That's what our business is. And "sold not bought" is a positive, not a negative.

GALLANIS: *Very well said. Let's think a little further about the people who need to be considering life or annuity products. For example, how do demographics fit into developing a corporate marketing strategy and helping people figure out the steps they should be taking as a 20 year old, 30 year old, 50 year old, etc.?*

MATHAS: I think it's very important for us to understand what demographic changes are taking place in the markets that we're serving. What I love about demographics is you can see it coming. There are many things in our business that we try to prepare for, but the reality is, it's sort of binary—it either happens or it doesn't happen. Demographics are happening, and they take a long time to happen. For businesses that have a long time horizon, it gives you a chance to plan appropriately.

So there's no question there's a positive side for our industry, given that one of the things we can do is provide people with risk pooling, spreading of mortality, and guarantees as people enter the retirement phase in their lives—a phase that's getting a lot longer thanks to increasing longevity. This is a great opportunity because there are very few private industries that have the ability to do what we can do in the back half of someone's life. There's additional value added from our products in terms of risk pooling that actually makes it easier for people to meet their retirement income needs.

Some people say that means that the future of the life insurance industry is all about annuities. That's a great market, but that's not what we're all about. People still die prematurely and unexpectedly. People still leave behind kids who aren't going to get to go to college if they don't have life insurance. Today we think of people living so long, but there's a 1 in 10 chance that a young person will lose a parent before they turn 20. So there's a huge need there, even with the aging of America.

Now when we talk about the next generation, we talk about their technological comfort. There's no question that people in their twenties today, maybe even in their early thirties, think of the Web as a trusted source of information. We have to factor that into how we do business.

But they still have life stages. People buy life insurance because they get married, because they have kids. And, it's quite obvious that people are still getting married, and they're still having kids. So I think what's important for us to do is focus upon what doesn't change as well as what is changing. If we keep our business focused upon providing security, providing it in a trusting manner to people, and recognizing that people will need advice, we can do that.

The analogy I would use is this—let's say I want to be in the music business. I believe music has always been important to people, it always will be important to people. I don't want to be in the album business, the cassette business, the eight-track business, or the CD business. I want to be in the music business. And if we stay in the music business, we're great. When we start thinking of ourselves as being in the eight-track or cassette business, we're in trouble.

On one hand, how can you be against disclosure and educating consumers? But on the other hand, you have this huge moral hazard issue...

GALLANIS: *We've been through a really tough time in this country economically over the course of the last few years, and there are questions about whether we may be dipping back down again. For example, A.M. Best recently announced that it's likely to revise its sector rating for the life industry from stable to negative, based on economic uncertainties in Europe, the pace of the recovery, and the fiscal situation in the United States. I wonder if you could offer some thoughts on where you see the economy going short- to medium-term, maybe long-term if you'd like, and what that may mean for life writers and the people considering buying life products over the next few years.*

MATHAS: Before I guess, I would say I don't think anybody can predict where any of the markets are going. Being the CEO of a large company doesn't give you any better insight about that than any other person on the planet.

I think our business is about being prepared for whatever could happen—it's about being prepared for the unexpected. Our job is to consider a wide range of scenarios and how we think about the world and ensure that in any one of those scenarios, we're going to be able to live up to the promises that we make.

What I will say about today's environment is that when you do your basic distribution curve of possibilities, the tails are probable fatter than they have been in a long time, which means that the possibility of bad things occurring is probably higher than it had been. I can't tell you which of those bad things will happen. I don't think anybody can, but I think that we're navigating something where the odds of the Goldilocks "just right" kind of scenario are lower.

Because memories become shorter and shorter, what happens is that you get the situation where if something hasn't happened in 20 years, people basically think it never happens. And really, 20 years is not a long time, especially in the kind of business we're in.

I think that's human nature, but now we've even compressed the timeframe under which we look back for what could be a reasonable outcome. You take what happened in Japan. It's unbelievable, and it's a horrible human tragedy. But, this has basically happened 7 times in the last 500 years—pretty much every 70 or 80 years. It's not actually unexpected that Japan is going to have an earthquake and a tsunami. Just because you can't predict the day or the week or the year doesn't mean that the event is unexpected.

It doesn't mean that it's not unbelievably tragic. It is. And it doesn't mean it's not surprising the day it happens. But it's not surprising in the course of history. So when I look at issues that affect our business—interest rates, for example—I consider the fact that we have been in a fairly benign interest rate period for 20 to 25 years, which has had a big, mostly positive impact on our business. The slow downward trend in rates has actually been very good for life insurance companies. Where we are today, however, is not, and the possible outcomes of either being in a very low scenario for an extended period of time, which is horrible, or a spike in rates, which is also horrible, are both much more realistic than they were maybe 10 years ago.

The same is true of the regulatory environment. For all of the things that you can say about the regulatory environment, it's actually been fairly benign for 15 or 20 years. We are in a period of time now where the possible ways it could go are dramatically different. So I think we're moving from a period of relative stability to one of greater uncertainty—the tails are wider. Our business is about being prepared and helping people prepare for the tails, so we need to be much more conservative in terms of how well we're prepared for a wider range of scenarios.

Leading up to the financial crisis, the opposite was happening. There was too much reliance on models that purportedly could predict everything. Some started to believe that if there's only a 1% chance of something happening, you need to hold much less capital. Give me a break. That's not real. A risk is a risk—and if it happens, it happens. I don't feel better saying it was only 1 in a 100. Guess what? Those 100-year floods happen, and we're supposed to be prepared for them. That's what insurance is. It's about preparing for the unexpected.

GALLANIS: *As it turned out, the life insurance industry was well prepared for the financial crisis, though that wasn't a certain outcome to those of us watching developments at the "trough" of the crisis. That uncertainty—in the midst of the crisis—seems to have caused a fair number of life and health company CEOs to think about and focus on the guaranty system in a way that they really hadn't done for at least two decades. What are you hearing about the guaranty system these days from your fellow CEOs? And what do you think they expect of the guaranty system?*

MATHAS: I think for many people in the senior positions of the companies, if you look at the level of turnover and other things that have happened, they actually didn't have a good understanding about how the guaranty fund systems work. Because they all believe they run their companies in a way that they're never going to need to know. You don't run a company assuming that one day the guaranty system will bail you out.

So you don't really spend much time thinking about it. And since there actually hadn't been an assessment of any significance in a very long time, there really was a dearth of education and understanding about the guaranty system. So what happened in 2009 was there was such a crisis of confidence in the country that a lot of insurance people started to be fearful about our industry as compared to all of the government guarantees that were starting to be placed. You know, don't worry, money markets are protected. And then there were also guarantees that had been out there for a while that people understood better, like the FDIC—there's a high level of familiarity there. Even if people don't fully understand it, most people sense that they can't lose the money they have at the bank.

The feeling was that people didn't understand the guarantees behind annuities and life insurance because as an industry, we've had a difficult time explaining the financial strength story. So I think that confluence led a number of CEOs to look at guaranty funds as a first-order issue, since they probably have spent almost no time in their careers thinking about these funds. If they did think about them, it was in the context of, "I've got to pay what?" And so immediately, they honed in on this issue of how the system works and also transparency or disclosure.

I now think people have become more educated, and what they've learned, they don't really like that much. I'm not saying there is anything wrong, but it was different than what they expected. And that is not a comforting feeling. So they're dealing with having to write checks, and that's leading to a positive kind of dialogue, which is focused on three issues.

One is looking for greater uniformity. Almost across every company, whether you are more comfortable or less comfortable with state regulation, you still want uniformity. If you are doing business nationally it's better to have uniformity.

The second is there has been a huge change in the kind of products and features that are out there. So CEOs have concerns about how the guaranty fund system would work for living benefit riders on variable annuities and things that didn't exist 10 years ago. How might that work? Do we understand how they work? There's concern around what you might call product coverage.

GALLANIS: *Is that more an issue of maximizing coverage, or is it an issue of clarifying what the coverage is?*

MATHAS: I think it depends on the company. You're going to have companies that think it's not clear, and you're going to have others who say, "I don't really like a guaranty system providing protection for things that maybe we shouldn't be doing."

I'm not saying that's New York Life's position. But we don't sell guaranteed minimum withdrawal benefit features. And the reason is I don't believe insurance companies really know how to put guarantees on equities any better than the markets do.

Now, I said we make guarantees in tail events, right? Well, the issue there is that if we've guaranteed mortality, you can have pandemics. But fundamentally, we have a lot of experience to base that upon. And on any given day, most people aren't going to die. But when you guarantee equities, everybody needs help on the exact same day. It's the day the equity market goes down. Now, when the guarantees are tied to death benefits, I'm okay with that. Why? Because you have to have the markets down and everyone has to die on the same day, I can manage that.

GALLANIS: *More predictable.*

MATHAS: And the third issue with the guaranty funds is disclosure, and I think that's the biggest and that goes to this issue of, what do we mean? Pre-sale, post-sale—why do it? On one hand, how can you be against disclosure and educating consumers? But on the other hand, you have this huge moral hazard issue if you get to a point where people think no matter which company I do business with, it's all guaranteed.

If you think companies are starting to manage their businesses differently in recent years, with a shorter-term horizon, and aren't so worried about the tails, wait until you see what happens when all of a sudden financial strength actually *doesn't* matter in any way as it relates to competitiveness at the point of sale.

So I hope we can get through ELNY and Penn Treaty and use this as an impetus to address these issues. Because it's a system that in my opinion fundamentally

works. If you look back, 96% of the dollars have been returned to people following the few insolvencies that have occurred.

AUDIENCE QUESTION: *How do you get younger people to be more aware of insurance products and get them started early?*

MATHAS: It's a job we've had for years and years and years. I think part of that challenge is that a lot of our business is life-event driven, and people are having life events later in life. They're getting married later, they're having kids later. So the things that drive you to be a little bit more fiscally responsible happen later. And we all know the statistics—if you start saving early and doing some of these things early, it pays off later in life.

So I think we've got to figure out a way to make it more relevant to people earlier, to make it more part of the dialogue. And I think a lot of that can be through vehicles like online education and the like. If I'm 24 years old, I'm definitely not thinking about where I'm going to retire, how that's going to work. That will never happen.

But I am wondering about what's going on in the world today. I am wondering, "Am I going to have a job, am I going to have stability?" Perhaps we can leverage some of that sense of uncertainty to get people to try to focus a little bit more.

You had a generation that came out of World War II that was different in terms of their behavior. We may have a generation that comes out of this period of time in our country's history that is also a little bit more focused. You are still 22, 23, and 24, and your view of risk and risk aversion is very different, but I think with some fundamentals, you might be more open and receptive. So I would probably lean into what's going on in the world today and use that as a platform to open up a dialogue with somebody.

AUDIENCE QUESTION: *How would you react if one of your major competitors was designated by the FSOC as systemically important, but your company was not?*

MATHAS: I guess we've thought about that from every angle. Number one, trying to be intellectually honest about it, I don't think New York Life is systemically important, but I also think that's going to be a little bit in the eye of the beholder. I can look at the nature of the risk we take and the nature of the business, but I think it's more about this interconnectedness issue. So I think businesses that are more linked to things like the equity markets have more of a chance of making that list. That doesn't mean they should be systemically important or significant. But they have

more of a chance, because it's more likely that when something bad happens, it pulls them down.

Do I think anybody in the life insurance business should be? There are a couple in the close call category, given the nature of the disparate businesses they have and their size and impact.

I actually think there's a good argument that none of the life insurance companies should be deemed systemically significant. And I would be very comfortable with that outcome, because I think that fundamentally life insurance companies are very different than other financial institutions. It's very important to understand the nature of the liabilities that life insurance companies have, not just the size of the assets they manage.

As a mutual company, a lot of rules come down that we don't have to adopt. But we adopt many of them anyway—if they make sense. So I look at it this way: If we get to a point where a couple of our competitors are deemed systemically important and the perception starts to be that somehow they're stronger or safer because of that, whatever the standards are that they're managing to, we're going to manage to those exact same standards and make sure people understand that.

It's very similar to how I don't have to worry about Sarbanes–Oxley at New York Life, but I actually have as rigorous a process for auditing our financials as any company out there. I can say I don't have to deal with all of the Sarbanes–Oxley requirements that others have to do on a quarterly basis, but our controls are as rigorous. We would be communicating to everyone that we don't have to mess with all the federal stuff around FSOC, but fundamentally, what they are asking those companies to do—such as how much capital to hold—we are doing those same things. So I don't lose much sleep over it because I feel we can navigate it no matter how that comes out.

AUDIENCE QUESTION: *One of the things we worry about in the guaranty system is what kinds of things we may look at in the future. Given the demographics of the Baby Boomer generation and their needs in retirement, what kinds of product changes do you see coming?*

MATHAS: You know, we've had increases in longevity, and basically the life insurance industry has benefited from that. We all start rightly taking on the responsibility for helping people and having income guarantees that last throughout their lifetime. But I do worry about that bet becoming too lopsided over a period of time.

So without going into specific products, that's something we need to be mindful of. I worry about us taking bets where essentially, you're not actually spreading risk. I mentioned earlier, I worry about some of the equity product designs. Fundamentally, risk pooling works—it makes sense that we can do something by bringing a bunch of people together that individually, they can't do. But when you're placing certain guarantees that are tied to market events like equity market performance, you're not spreading risk. You might be hedging that risk in the markets, but you're not spreading it out.

We're in the business of guarantees, and that's one of the big advantages we have—people need some guarantees. Let's just make sure that we're guaranteeing things that we can fundamentally price for—things where we can actually be wrong on any individual bet, but we won't be wrong in total. I get nervous when I see life and annuity products and features that are more geared to providing protection for these somewhat "one-time events" where everybody hits at the same time.

So, on the positive side, I think there is a lot of creativity in the industry around trying to meet some of these demographic challenges. I think we are uniquely positioned to go after those. If you're looking for developments, you're going to see them in the area around providing lifetime income benefits, lots of different products and features around that.

And then I think ultimately we also have to stay in the business of figuring out how to help a person cover the health risks they face, whether that's long-term care or the like, because we know that is there. And I worry about the industry's early mispricing of that leading to us not being there to help people with that over the next 20, 30, or 40 years. ✯

["State & Federal" continues from page 1]

their most vulnerable. We immediately went into a mode of making sure that we were able to assist the recovery efforts—the first responders, if you will: FEMA and our state equivalent of FEMA—but then immediately go into insurance recovery.

And I will tell you the industry response has been so commendable. The tornado took place about 5:30 on Sunday night and by 10:00, we already had mobile catastrophe units from some of our larger carriers on the scene. By Monday morning, they were all there.

I've been down there several times. We have put together a Joplin recovery team for the department, and I suspect it will have at least a year of a heavy load. We've hired an industry expert—a former market conduct regulator—to be our on-site person there in Joplin. And just to give you an idea of the extent, when you think about a community of 50,000 people, five weeks post-disaster the industry had already reinvested over half a billion dollars into that community. Eight weeks post-disaster, that number is up to $745 million. Those are significant dollars that are being reinvested in that community.

The rebuilding of Joplin—I have been saying this when I speak to folks—will be based on two major ingredients. Certainly, the resilience of the people—the Missourians that live in that area, you can't imagine their true grit and determination to rebuild their community—but also the reinsurance capital of the global marketplace. Those funds are only available because of our strong state-based insurance system—I call it our nationwide state-based system—and our ability to tap into the global reinsurance market.

So the recovery is ongoing. We've made great progress, but there's still a lot of work to do.

NJ: *Turning to other insurance matters, there have been reports that the Financial Stability Oversight Council (FSOC) wasn't allowing you to share information with your fellow insurance commissioners. Has that issue been resolved and, if so, how?*

Huff: We are hopeful that as we get more into company-specific information, we'll make progress in this regard. We're still very concerned about the issue because we think that state regulators—particularly the functional regulators of individual companies being assessed—possess expertise and knowledge about individual companies that will be vital to the process. We also continue to be concerned that I can't consult my fellow regulators regarding other confidential matters being discussed that could impact insurance, including the criteria that may be used by the council to designate non-bank financial companies or systemic risks that could impact the insurance sector.

It's my view and the view of NAIC that traditional insurance activities do not pose systemic risk.

So we have six NAIC staffers to assist me—a property and casualty insurance expert, a life insurance expert, a capital-markets expert, a financial regulatory/data expert, and two attorneys.

We also have Director McRaith—our nation's first FIO director—in place. He took office in early June, and he attended the July FSOC meeting. And we've had the confirmation hearing of Roy Woodall as the presidential appointee. He hasn't been confirmed yet, but his Senate hearing obviously went very well, from all accounts. And so I'm hopeful that he'll be able to join very soon. And I truly think that would make a difference in educating people about the differences between insurance and banking, with a council that's very bank-centric.

NJ: *Some press reports have depicted you as the "lone voice of insurance expertise" on the council. What is your view of the level of insurance knowledge among your colleagues?*

Huff: Director McRaith has a long history of being the Director in the Illinois Department, so he brings a great deal of expertise. So right there, we've doubled, right?

What we try to do, as best we can in light of the confidentiality restrictions, is talk about general themes under Dodd-Frank, with our expertise within the state-based system at the NAIC. So we're able to contribute that way, but we still need to be able to bring functional regulators to the table. I think our next focus will be the consultation process, if you will.

If you think of any exercise where there may be a designation process, you start with a very large universe and you have a funnel of trying to get down to companies that will be under consideration to be designated as a systemically important financial institution. And so the question will be, when do state regulators—the functional regulators—start engaging in that process?

NJ: *Speaking of that process, the FSOC has been criticized for being slow to issue its criteria for systemically important financial institutions (SIFIs). How do you respond to those criticisms?*

Huff: Some people say the FSOC has moved too quickly, and others say it has not moved quickly enough. I think it's more important for us to do it correctly, to do it in a comprehensive manner, than to rush to judgment. And I've been particularly concerned about any efforts to make the process move more quickly until we have more insurance expertise available to the committee.

We issued the advance notice of proposed rulemaking for the designation process back in October, and then a notice of proposed rulemaking earlier this year. And there's been a strong indication from members of the FSOC that there will be yet another opportunity for interested parties to give comments about the process, so that there will be additional guidance given by the council for the process. We're still working through what the terms of that guidance will look like. Hopefully, that will be out in the near future, and we'll get more feedback from folks.

I think that's very important, because I think the market wants to have as much certainty as possible on what would constitute systemically important financial institutions. And I think that we have not established that certainty in the first two rounds of the rulemaking process.

NJ: *In your opinion, are there any systemically important insurance companies?*

Huff: It's my view and the view of NAIC that traditional insurance activities do not pose systemic risk. Having said that, it is possible that certain non-traditional insurance activities, or activities from non-insurance affiliates, could potentially pose or be a conduit for systemic risk. But I think it would be a stretch to say that traditional insurance companies would be systemically risky.

NJ: *What about the monolines?*

Huff: That's certainly an area open for discussion. And I think we've seen recent struggles in some of the monolines throughout the crisis. I think it's certainly worthy for us to study monolines, but we need to primarily focus on the impact of failure rather than the probability of failure.

What if an entity fails? Does that have systemic ramifications? If there's a company that's not able to perform in the insurance industry—and we do have failures; not everyone should own an insurance company—the industry closes ranks and we have a resolution process. And we have a way to limit the loss for consumers but also address how the marketplace takes up that gap with competition.

And the industry had a very strong record through the crisis. Out of 8,000 insurance companies, I think we have, what, 27 or 28 failures. So our sector was perhaps the strongest of the financial industries.

NJ: *What about a large, international reinsurer? Is there a chance one might be considered a SIFI?*

Huff: Generally, I think it's important that we don't allow the discussion to be solely about the size of an organization. We shouldn't in any way try to inhibit a company from strong economic growth, particularly in this economy.

I think the FIO has the potential to help enhance state-based insurance regulation.

That's not to say we should allow companies to grow recklessly, but within our regulatory structure, we should allow companies to grow. Dodd-Frank is very well-written in this regard; it has a variety of factors for the designation process. Our industry is large, and we have some very large companies, but again, size is not the only factor.

NJ: *As you mentioned earlier, impact has to be the leading factor.*

Huff: Right. Should size be the only factor? We have large entities within our structure, but that's not to say that they all should be systemically important. We think the existing structure of state-based insurance regulation provides more than adequate protection.

NJ: *Speaking of large insurance companies, some regulators have said that AIG's problems back in 2008 were solely in the Financial Products Division and that the insurance subsidiaries were sound. Do you share that view, or do you think that there were some significant problems in the insurance subsidiaries as well?*

Huff: Overall, I do share the view that the underlying issues directly resulted from the Financial Products Division. Which, by the way, was regulated by a federal regulator.

Having said that, I think we did learn some lessons, and we showed the strength of state-based insurance regulation. We did, early on but before the crisis, identify some areas with securities lending at AIG—areas where we thought the growth was too rapid. And we were addressing that issue pre-crisis.

So there certainly were some AIG issues pre-crisis, during the crisis, and post-crisis. But the strongest parts of AIG—and this was certainly demonstrated by the financial strength of that entity in the ability to continue to pay back any relief from the federal government—were those insurance entities. They remain strong today.

NJ: *We're about a year into the Dodd-Frank overhaul of financial regulation. What is your view of the Act and its likely impact on the financial services sector?*

Huff: Well, I think the FSOC aspect of Dodd-Frank is very important. If you think about it, it's what state-based insurance regulators have done all along—collaborate, cooperate, and talk. Have peer review with one another.

So that's a positive aspect. I think that the establishment of the Federal Insurance Office is positive. I think the FIO has the potential to help enhance state-based insurance regulation. There's an opportunity there for some healthy tension, if you will, in the areas where state-based insurance regulation may need a nudge—more uniformity, for instance. The bully pulpit of the FIO may be a good way to give us that nudge.

If you go through Dodd-Frank, the FIO really has more of an advisory/monitoring

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role, but let's not fool ourselves. That office will certainly have a substantial impact in the marketplace for insurance and certainly have a voice. But they are not a supervisor, and they are not a regulator. A very strong part of Dodd-Frank is that it preserves state-based insurance regulation.

NJ: *How else do you think the Act will affect the insurance sector?*

Huff: It certainly preserves state-based insurance regulation; that's first and foremost. And I think it also carves out a role—a continuing role—for state-based insurance regulators internationally. One of the positive aspects is having the FIO to help with international agreements and to help the insurance sector—in what is really a global marketplace—to have a single voice on insurance from the United States.

But because of the way the FIO's role is structured, I still see a very vital contribution from state-based insurance regulators internationally. Because we remain the functional insurance regulators in the United States.

NJ: *What do you think will be the most significant benefits from Dodd-Frank?*

Huff: There are a variety of aspects, but I think the overall theme is coordination among the financial sectors. Dodd-Frank will create more of a "non-siloed" and coordinated environment. Because the risk, if that's not accomplished, is what we've already experienced: regulatory arbitrage, seeking the lowest common denominator. So that's the challenge, and that's why the coordination role in FSOC, within sectors, is so critical.

NJ: *On the flipside, do you think there are any opportunities that were missed in the crafting of the bill?*

Huff: Actually, I think the bill is quite well-written for the insurance sector. Our challenge will be implementation, and to ensure that there is no mission creep of people interpreting the bill in an overly broad fashion.

For instance, take the struggles we've had with getting insurance regulators more involved in FSOC. I think the bill is pretty clear in that regard, but it's open for interpretation. So that's been a struggle with folks reading it too narrowly. And Treasury, for instance, has been criticized by Democrats and Republicans in two congressional hearings for reading the bill so narrowly.

NJ: *Speaking about federal regulatory supervision under Dodd-Frank, how are you and other state regulators creating a working relationship with the various federal agencies supervising or studying the state regulatory system?*

Huff: The appointment of Director McRaith is a great step forward for that relationship. Building the relationships there will be vital.

As we talk about state-based insurance regulation, it's easy to talk about challenges we've had or areas where we've had misses. But the performance speaks for itself. So I think we should have a healthy dialogue and be able to identify our challenges and ways we can improve. But the financial crisis was not originated by the insurance sector, and so, if it ain't broken, let's not fix it too much.

NJ: *In speaking of the FIO, you mentioned the potential benefits of the "bully pulpit." Do you see any major changes arising from the federal studies of the efficiency of state regulation, such as the FIO study due in January 2012?*

Huff: I know there's been criticism of the FIO study—sort of a "fox watching the henhouse" situation. The NAIC and I hope the report will be honest and factual, but we continue to believe there is an inherent conflict in an office of the Treasury Department studying ways to further empower itself. While the national state-based system of insurance regulation has successfully protected the interests of consumers for decades, state regulators recognize that, like any regulatory system, it is not perfect, and we are open to hearing any suggestions FIO may have for improvements. To date, the NAIC has had a good relationship with FIO, and I look forward to continuing that relationship going forward and working with my friend and former colleague Mike McRaith.

NJ: *Have there been any changes already, whether as a result of Dodd-Frank or just the financial crisis that brought about Dodd-Frank, in the way insurance is regulated—in the way you're protecting insurance consumers?*

Huff: NAIC has made some significant changes on securities-lending reporting, for instance. That's an area that has been a pretty big plus, where we're doing quarterly reporting on securities lending.

One thing I think NAIC is good at is doing a self-critical examination throughout their processes. And right now we're in the middle of the Solvency Modernization Initiative or SMI, which is a critical self-examination of the solvency scheme of state-based insurance regulation. Of all the areas we're looking at, one of the biggest is the Group Solvency Issues Working Group, which is looking for ways to get a better view of conglomerates that involve insurance and non-insurance affiliates.

So if you think about the lessons learned from the financial crisis, one thing we've learned is that insurance regulators are really good at setting up the walls, protecting legal entities of insurance companies, and not letting those assets that are already set up to protect consumers be taken away by holding companies.

What we realized we could do better, which will come out of this Group Solvency Issues Working Group and the entire Solvency Modernization Initiative, is setting up the windows through the walls. How do we look at those legal entities and look into the conglomerate to see what non-insurance activities may be impacting the insurance subsidiaries?

I think you're going to see a great deal of activity in terms of group-solvency assessments—that will come in terms of the new holding-company model law that was just passed by NAIC late in 2010. I believe there are now two states that have passed that, and I think you'll see a flurry of activity next year in states passing that new act. You'll also see a great deal of activity related to enterprise risk management—getting a sense of how companies, particularly companies of a certain size, manage their enterprise risk management.

ORSA—Own Risk and Solvency Assessment—is the new term that's being used in some European jurisdictions, and it looks like we will be leaning toward that in terms of the U.S. requirement. It's sort of a self-assessment by companies, with regulators being involved in that process.

NJ: *Moving from solvency to insolvency, the NAIC recently created the Receivership Financial Analysis Working Group, or R-FAWG, as well as the Dodd-Frank Receivership Implementation Working Group. What are those groups doing to help address the need to "lift the state receivership game" and provide for a sound working relationship with the FDIC in an "orderly liquidation" involving an insurer?*

Huff: The ultimate goal of R-FAWG is to help state receiverships wrap up sooner while protecting all policyholders. The group, formed in 2010, is already improving accountability and communication.

The nine-member panel of state regulators, all of whom are receivership experts, will consult with and require accountability from domestic receivers. Regarding communication, R-FAWG will improve information flow between the domestic receiver and other states with affected policyholders.

If an insurer designated as a SIFI under Dodd-Frank goes to receivership, R-FAWG will be involved, and I foresee a good working relationship with the FDIC.

NJ: *I know Missouri played a major role in the Lincoln Memorial/Memorial Service insolvency, which had a huge effect on the funeral home business and the people it serves. How were consumers protected in that case, and what lessons did you learn from it?*

Huff: Well, we certainly had lessons learned in Missouri. We had significant statutory reform on the pre-need funeral industry in 2009. In fact, it was the first bill that came out of the state Senate—that explains the importance we put on that issue. It's an area that needed more oversight.

But the guaranty associations are certainly to be commended for the role they played in that insolvency—the conservative, capable protection of consumers in that process. And I think we still have a ways to go there, but it really underscores the time horizon of insurance companies: not only the selling of products, but the unwinding, if you will, that comes with them. It's so different from the banking side, isn't it? It's not just that you go out and you have a fear of a run on the bank; these are long-term issues that require thoughtful resolution.

Looking to the future, the solvency of long-term care insurers is a potential area of concern in the next 10 years. I say this based on the track record of pricing models that have proved troublesome in some cases.

Your readers may be familiar with National States, a Missouri domestic long-term care-insurer. As we announced when we took the company to receivership in 2010, National States's initial rate filings offered inadequate prices, and as a result the company was never able to recover. So this is a line of insurance we'll watch carefully. ✭

We continue to believe there is an inherent conflict in an office of the Treasury Department studying ways to further empower itself.

NOLHGA's 28th Annual Meeting
October 11–12, 2011 › InterContinental Chicago

Our Kind of Town

NOLHGA Calendar of Events

2011

October 10	**MPC Meeting** **Chicago, Illinois**
October 11–12	**NOLHGA's 28th Annual Meeting** **Chicago, Illinois**
October 16–18	ACLI Annual Conference Orlando, Florida
November 3–6	NAIC Fall National Meeting Washington, D.C.

2012

January 9–11	**MPC Meeting** **Orlando, Florida**
January 18–20	IAIR Insolvency Workshop San Diego, California
March 3–6	NAIC Spring National Meeting New Orleans, Louisiana
August 11–14	NAIC Summer National Meeting Atlanta, Georgia
October 1–3	**MPC Meeting & NOLHGA's 29th Annual Meeting** **San Antonio, Texas**
October 21–23	ACLI Annual Conference Washington, D.C.

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