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How has the last decade changed the regulatory landscape, and what must the guaranty system do to survive and thrive in the future?

By Charles T. Richardson

It seems like a good time for a retrospective on the federal/public policy front as I head into retirement in 2018 shouting "Satan, set me free!" What a ride the past 45 years have been—one job at one firm. But let's focus now on the last 10 years.If I were to try to capture the guaranty association regulatory developments and the things that matter most to us, that decade would have to be divided into four time segments:

Before the Great Recession: In this period, we saw a high-level examination of regulatory issues, some discussion of "federal chartering," and mild interest in guaranty system capacity and capabilities as a sideshow to the main event of the industry being disturbed by state regulators and the state-by-state web/patchwork that slowed down getting products to market. Questions emerged, such as: Will the industry stick with us? Can we educate Congress and other thought leaders enough about what we do? Will there ever be a true federal role in insurance, and how do we position our system in response as the debate unfolds?

During the Great Recession: Highlights include American International Group, critical analysis of our capacity/capabilities, and the Dodd-Frank Act debate and passage. The questions, spotlight, and critiques accelerate to a whole new level, both on and off Capitol Hill. Are the states up to the task of both regulating giant insurance firms and cleaning up the mess if they fail? Should the guaranty system be "carved into" Dodd-Frank?

Post–Great Recession and Dodd-Frank: Now we see an international focus and federal agencies getting into the insurance game to a larger degree: the Federal Insurance Office (FIO), Federal Reserve Board (Fed), Federal Deposit Insurance Corporation (FDIC), International Association of Insurance Supervisors (IAIS), and Financial Stability Board (FSB)—with the National Association of Insurance Commissioners (NAIC) playing catch-up and spending more and more time on international/national issues. We also see NOLHGA as a key thought leader and explainer in the conversation about policyholder protection and resolution: For example, consider the public support from the trades and the NAIC in connection with the FSB Consultation on resolution issues in early 2016.

["Looking Back & Looking Forward" continues on page 20]

IN THIS ISSUE

Lessons of History

The following was adapted from my President's Address, delivered on October 19, 2017, at NOLHGA's 34th Annual Meeting.

Most of you have heard me say that Bob Ewald—the founding father of the guaranty system—often referred to this address as a State of the Union address for our system. Bob wasn't able to join us this year, and I'm sure I'm not the only one who misses him. He would have enjoyed the meeting, as he enjoys all our meetings, but I think that he really would have enjoyed the speech yesterday by historian Lynne Olson. Not only because Bob has the mind of a historian, but also because Bob's interest in World War II is more than simply academic. He served in the infantry in World War II, in the Pacific Theater, and I know that he would have some stories to tell us, were he here.

History is made up of stories. The work of the best historians, like Lynne Olson, is a balance between tracking the sweep of history while also keeping an eye out for those moments that perfectly capture the currents that shape the world. A meeting between two leaders, a small battle in a larger war, a decision made in solitude that changed the lives of millions—these are the moments that bring history to life.

I'm reminded of one of my favorite quotations, from the novelist Ann Beattie. She said, "People forget years and remember moments." It's human nature to misplace a decade but to remember a lunch with a dear friend.

With that in mind, I'd like to single out a few moments in the 30-plus-year history of the guaranty system and try to find some deeper lessons we have learned from them—a Top 10 List, if you will.

Many of these lessons date back to the 1990s and even the 1980s. In the interests of my brevity and your wakefulness, I won't be doing a "deep dive" into these events, but I encourage anyone interested in learning more about them to visit the NOLHGA website's members-only section, where you will find a report by NOLHGA's Tony Buonaguro and Jana Lee Pruitt on the history of the guaranty system. I highly recommend it.

So, without further ado, here we go.

Number 10: Baldwin-United

The Baldwin-United insolvencies in the early 1980s essentially brought about the establishment of NOLHGA, but they did more than that. They were the first significant life/health failures to take place under the NAIC's still-relatively-new Life and Health GA Model Act, and they taught us that the paradigm underlying that original version of the Model—the failure of a small, single-state or regional insurance company, really based on prior P&C experience—simply didn't work with a larger, national life insurer failure. The industry and regulators learned that they had to reexamine the Model in light of economic and marketplace realities. Reality can be pesky that way.

We also learned a lesson that's just as true today as it was then. Nationally significant cases require the cooperation of the guaranty system, regulators, and receivers across state lines. Without a mechanism and process to facilitate that cooperation, no resolution plan has a hope of success. Hence the establishment of NOLHGA.

And finally, we learned that, in large insolvencies that are likely to cost guaranty association member insurers a great deal of money, early and significant involvement by the industry is indispensable. Crafting resolution plans for large, complex insurers requires creativity, and the industry is a great source for that creativity. Not to spoil the rest of my speech, but you may hear that point again.

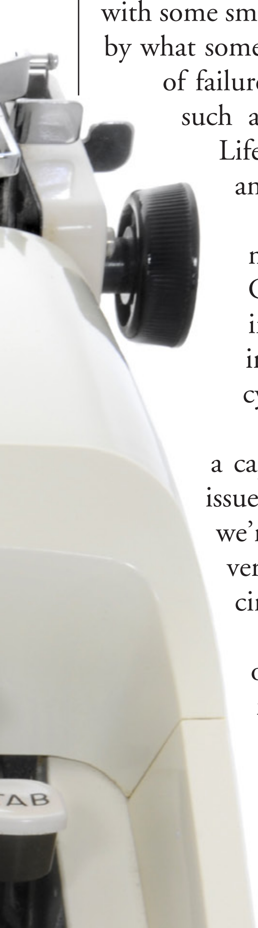
Number 9: The 1988 & 1991 Insolvency "Waves"

We haven't quite escaped the gravitational pull of the 1980s yet, but we're close. In the late 1980s, we saw some significant P&C failures: companies such as Mission and Transit, along with some smaller carriers. This was followed a few years later by what some people considered a significant "second wave" of failures—this time of major life and annuity writers such as ELIC, Mutual Benefit, and Confederation Life, along with a number of smaller life, annuity, and health writers.

At the same time, the country was just beginning to emerge from the Savings and Loan Crisis. These events were not unrelated, and in fact they helped teach us that patterns of insolvencies can emerge from changing business cycles and market trends.

We also learned that the guaranty system has a capacity issue. Not so much a financial capacity issue, but a human resources capacity issue. When we're hit with a wave of insolvencies, we have to be very careful how we allocate our time. And in such circumstances, time is both money and people.

How do we set up our task forces and align our external resources? How do we communicate and coordinate with each other across insolvencies so that similar issues are treated consistently?



In large insolvencies that are likely to cost guaranty association member insurers a great deal of money, early and significant involvement by the industry is indispensable.

We learned to answer these questions in the early 1990s, and it's a process that we continue to fine-tune to this day—witness the MPC group now tracking CO-OP insolvencies and ACA-related issues.

At the risk of patting ourselves on the back, we should also note that this time period was when the guaranty system began to prove that the guaranty associations can handle the job for which they were created—and we did this in the face of some very unhealthy skepticism from regulators and even from some in the industry itself.

Number 8: Failed Promises & Wishful Thinking

These are more than possible titles for Taylor Swift's next album. *Failed Promises* was an enormously influential report from the Government Accountability Office, championed by Rep. John Dingell. Rep. Dingell was an ardent supporter of federal regulation of insurance—I think it's fair to say that he viewed the state-based regulatory and resolution processes with contempt—and the report offered a scathing indictment of state insurance regulation's ability to live up to its promises in the first wave of insurer failures I just mentioned. The *Failed Promises* report, which was issued in 1990, was followed in 1994 by *Wishful Thinking*, which took a similarly dim view of how state regulation handled the second wave of insurer insolvencies.

What did we learn from these reports? First off, that John Dingell really didn't like the state system.

More important, we learned that, when you're dealing with high-profile insolvencies, the world is watching—we are under a microscope. And when things go wrong, and consumers see tangible results of failures in the insurance world, there can be serious repercussions.

We came close then to a federal takeover of the insurance regulatory space, because there was so much dismay in

["President's Column" continues on page 22]

Southern Hospitality

At NOLHGA's 2017 Annual Meeting, the charms of Charleston help to offset some gloomy talk about the LTC and health insurance markets

By Sean M. McKenna

Any meeting dealing with a large insolvency, regulatory uncertainty, the turbulent (and that's being nice) health insurance market, and the even-more-turbulent (and that's being really nice) long-term-care market faces one fundamental question—how do you attract people when you're sure to be giving them some grim news? The answer is simple:

You follow the advice of noted meeting planner Mary Poppins, who reminded us all that a spoonful of sugar helps the medicine go down.

For its 2017 Annual Meeting, NOLHGA traded shrimp and grits for sugar by heading to Charleston, South Carolina. If the more than 200 attendees who ventured to the meeting in October were going to swallow some bad news (and some good news, which we'll get to soon), they would do it in one of the most beautiful cities in the South—and they'd eat well while doing it. The attendees may have left the meeting with some concerns about the future, but it's doubtful they left hungry.

Gloomy Forecasts

The 2017 Annual Meeting offered two industry forecasts—for the health and long-term-care (LTC) markets. Neither was particularly cheerful.

Leanne Gassaway (America's Health Insurance Plans, or AHIP) may have faced the more challenging forecast, since the debate over repealing and/or replacing the Affordable Care Act (ACA) was going hot and heavy at the time, with new bills and presidential tweets coming on an almost hourly basis. After breaking down the basics of the various bills then under consideration (none of which became law), she noted that "the market right now is not a stable place," which affects the industry and policyholders alike.

Gassaway added that stabilizing the market "doesn't take a ton of investment—it just takes action" on issues such as cost-sharing reduction payments to companies participating in the exchanges and delaying or repealing a tax on insurance premiums that she said adds 3% to premium payments. The key factors driving up premiums, she explained, are the people being covered and prescription drug costs. The mix of covered policyholders "is probably one of the biggest drivers" of premium increases—as healthy people leave the plans, costs go up for those who remain. "That is having a huge impact on the individual market today," she said, while adding that the group market—which has a far better mix because it serves vastly more people—is stable.

Prescription drug costs also play a part in premium increases. According to AHIP, more than 22 cents of every premium dollar goes to drug costs: "That is the fastest driver," Gassaway said, pointing to monopolies and "a very dysfunctional marketplace" as the key culprits. "Those are driving prescription drug prices—not research and development."

Peter Goldstein (LTCG) didn't use the phrase "dysfunctional" in describing the LTC market, but he didn't have much good to say about the market's current state. LTC spending in the United States in 2014 was $239 billion, and 63% was funded by Medicare and Medicaid; only 3% was funded by private LTC insurance. There are only a handful of companies still marketing stand-alone LTC products, he added (mostly mutual companies), though there are a large number of insurers with closed blocks of business being run off.

Every company with a closed block would like to get the liability off their balance sheet, Goldstein said, but "traditional buyers aren't interested in this stuff at all." Instead, interest is coming largely from investment companies eyeing the assets in those blocks. He pointed to six recent acquisitions, none with traditional reinsurers. A key issue in these acquisitions, he said, is "who's taking the risk for future rate increases. It's really hard to offload that risk on the buyer today."

It wasn't all doom and gloom, however. Goldstein said that "the growth of hybrid LTC products has been an exciting story for the companies selling

Historian Lynne Olson spoke at the Welcome Luncheon about some of the lessons of World War II, in particular the importance of the cooperation between the United States and Europe during and after the war. "The international order has been so successful for so long that Americans have come to take it for granted," she said.

More Annual Meeting Coverage

NOLHGA President's Address: Page 2 | NOLHGA Conversations: Adam Hamm & John Huff: Page 8

NOLHGA Conversations: Gary Hughes & Charles Richardson: Page 14

Eric Rangen (LTC Re)

these products," though he added that he wasn't convinced that hybrids were the solution to the industry's problems. "They're part of it."

He also pointed to savings-based LTC insurance, a universal life version of LTC that he felt would appeal to Baby Boomers who are more focused on accumulating and managing assets. He cautioned that such a product "would require significant regulatory changes, and those wheels don't turn very fast."

Something must be done, however, and Goldstein doesn't believe the industry can go it alone. "This problem is not going to be solved all by itself," he said. "We need government and regulatory help. We need to bring the greatest minds together to figure this out."

Penn Treaty & LTC Re

Two other presentations gave attendees a real-life look at what happens when a rehabilitation solution cannot be found for a failing LTC carrier. Penn Treaty and its subsidiary, American Network, were placed in liquidation in March 2017, and representatives from Penn Treaty (which now serves as the third-party administrator (TPA) for affected guaranty associations) provided a status report on TPA operations.

Bob Robinson (Chief Liquidation Officer) explained that everything the company does related

Chairs Call for Collaboration in Annual Meeting Addresses

Outgoing NOLHGA Chair Deborah Bello and Incoming Chair Mark Backe both pointed to the more-active role in the guaranty system being played by health insurers as key to the continued success of the system in their addresses at NOLHGA's 2017 Annual Meeting.

The successful resolution plan for the Penn Treaty/ANIC insolvency came about "because we were collaborative and inclusive," Bello said. "We didn't dismiss ideas by saying, 'this is the way we've always done it.' We moved outside our comfort zone for the good of the system and the policyholders we serve." She added that this collaboration must continue. "Having more health carriers involved in NOLHGA is a good thing. It's the next step, not the last step."

Bello also predicted better times for state insurance regulation. "I feel a lot more comfortable about the future of state regulation that I did last year," she said. Even here, though, that spirit of collaboration must continue. "The NAIC is looking at what aspects of federal recovery and resolution efforts should be 'folded into' state regulation," Bello explained, "and there are some good things." She cited the resolution planning required of large companies as one example. "There's real value in being prepared for the worst-case scenario, and all companies would benefit from having crisis plans in place."

She finished with a reminder to the audience that "we work best when we work together. Being open to working with people you don't always agree with—to having your mind changed when you thought or even knew you were right—is something we should continue to model."

Backe also welcomed health insurers, noting that many of them are "relative newcomers" to the guaranty system. "It's to TPA implementation, from its interaction with policyholders to its relationships with the guaranty associations, "is subjected to a rigorous project management approach." Implementation has been divided into different projects, such as NOLHGA/GA Planning, Financial Support Services, TPA Initiatives, Rate Increase Coordination, and Communications Coordination.

With approximately 70,000 policyholders and 6,800 active claims, "each case needs to be actively managed" said Sharon Reed (Senior Vice President, Insurance Operations). Each patient has a plan of care that determines the threshold for costs, and that plan can change due to changes in the policyholder's health. The company's call center is "such a key part of our organization" in addressing the needs of policyholders, she added, noting that guaranty associations have reported that they are not receiving many calls since the liquidation. "I hope that's because we're doing our job well."

One of the most complex projects has been coordinating the rate increase requests from different state guaranty associations. "Quality review of rate increase data is probably the most intense part of this process," Reed said, noting that there are more than 100 different possible coverage election forms for policyholders due to the variety of states, policies, and options offered with the rate increase. "We are

Leanne Gassaway (AHIP)

["Southern Hospitality" continues on page 25]

critical to the ongoing success of our system that we begin to build the same trust and camaraderie with our newest participants that we have with our long-standing colleagues," he said, encouraging state guaranty associations to ensure that major medical writers have a seat on their Boards of Directors.

In discussing the strengths of the guaranty system and the threats it faces, Backe pointed to "the remarkable adaptability of the system—our ability to draw on past experience to solve new problems." But he warned that this ability could be weakened as many veterans of the system retire. "We can't stop people from retiring, but we can and should take steps to preserve the institutional memory of the system."

He also called for a renewed focus on achieving functional consistency among all the state guaranty association laws. "We all know that there are valid reasons for differences among the state associations," he said, "But consistency makes our system and the work we do more understandable to our industry members and to policyholders."

Backe noted that the industry is placing a greater emphasis on the "customer experience," and he called on the guaranty system to do the same. "We need to take that customer perspective and make it our own," he explained. "To anticipate customers' questions, and answer them before they're even asked.

Looking to the future, Backe said that "the greatest threat to our system is being unprepared for a long-term-care insolvency," but he expressed confidence that the guaranty system will be ready when needed. "I know we'll rise to this challenge because we've risen to every challenge we've faced for more than three decades," he said. "Our safety net is strong, and it's getting stronger every day."

NOLHGA Conversations

"We Have to Find Some Common

Former NAIC Presidents & FSOC Members Adam Hamm and John Huff weigh in on federal regulation, healthcare, and the long-term-care industry

Adam Hamm is a Managing Director with Protiviti, focused on serving clients within the financial services industry concerning risk, compliance, and cybersecurity matters. Prior to joining Protiviti, he was a former President of the National Association of Insurance Commissioners (NAIC), Principal on the United States Financial Stability Oversight Council (FSOC), and North Dakota's elected insurance commissioner from 2007–2016.

John Huff is a partner with the Dentons law firm. He has more than 25 years of experience in the insurance sector, during which he served as NAIC President; a Principal on FSOC; and Director of the Missouri Department of Insurance, a position he held for eight years.

The following is an edited transcript of our conversation at NOLHGA's 2017 Annual Meeting on October 18.—Peter G. Gallanis

Adam Hamm, John Huff & Peter Gallanis

Ground"

Gallanis: *You both entered insurance regulation at about the time the entire world was reeling from the 2008 financial crisis. In September or October of 2008,* ***The Washington Post*** *was running stories every day about how the insurance sector was about to fail. What were you and your colleagues, as insurance regulators, worrying about at that time? And what steps were you taking or beginning to take in the face of that crisis, with some people questioning the prospects of the insurance industry?*

Hamm: I started in October 2007, because the person who had the job before me left with about a year and half to go in their four-year term. I knew I'd have to run in November 2008. And as things were starting to unravel, the first thing I thought was, "This is great. I'm going to be out of a job."

I pouted for a couple of days, and then I moved on. And I couldn't believe how quickly the narrative changed, during the financial crisis, to where people were pointing their finger in large part at the insurance regulatory system and insurance commissioners. In Washington, the drumbeat became consistent and very loud that the way the state insurance regulatory system is set up—with different commissioners and their unique political requirements and concerns in their states—that's why AIG started to melt down, which could've brought the entire system down.

It blew me away—how fast that narrative started to spread, not just in Washington, D.C., but around the country. So consistently in 2008 and even into 2009, we had to explain again and again and again that the insurance companies that are under the umbrella of AIG are completely solvent. They're following all the insurance laws and regulations in the states where they're doing business. In fact, as we all know, in large part those insurance companies were used to satisfy the debt of AIG.

We had to do that constant education process—that it really wasn't the insurance regulatory system. It was a federal regulator, the Office of Thrift Supervision, that had authority over that one unit of AIG in London that almost brought the whole thing down.

But once we got through it, we had to take a long, hard look at ourselves and the insurance regulatory system to see where there was room for improvement. That's what led to things like the Solvency Modernization Initiative, the expansion of group supervision, supervisory colleges, ORSA. All of that grew from this, because we realized that while the insurance regulatory system and insurance commissioners were phenomenal at walls—walling off the assets and making sure there was money there to take care of policyholders, and let's not forget the entire guaranty system as well—there was also the windows aspect. And that aspect—understanding exactly what was going on inside an insurance company or group—needed substantial improvement. That's what you saw insurance regulators working on after the crisis subsided.

Huff: I started a little later, in February 2009. In the fall of 2008, during the crisis, I was working in Zurich, which was terrible in terms of time zones. I would come home from work and watch the U.S. news about the crisis all night. At the same time, I was advising our new governor in Missouri on what he ought to be concerned about in financial markets. Long story short, he ended up inviting me to come help him with that.

I don't think there's any question that educated people in the insurance industry, everyone in this room, knows that the AIG bailout was for the counterparty risk to save the banks. But at the time, the uncertainty of the markets unfolding and the uncertainty of our system were impacting everyone. What was driving this downfall in the economy? And certainly, there were some specific issues that insurance commissioners tackled. You might remember the deferred tax asset issue that we had to work through.

Gallanis: *John, you heard Adam mention the NAIC's Solvency Modernization Initiative. Can you give us a bit of a refresher on that along with your assessment of how much it improved the regulatory mechanisms?*

Huff: After the immediate phase of the crisis, state regulators really did take stock of our system and what we could learn from the crisis. Clearly there were some central takeaways, not the least of which concerned our ability to monitor and regulate groups. And the revised version of the Holding Company Act became so important.

Let me tell you, I talk about the Holding Company Act almost every place I speak because it is, I think, the epitome of where state regulators work their best with stakeholders. Many of you were in the room when we hammered out the terms of that Holding Company Act, and not only did the NAIC move very quickly in adopting the model, but then states moved within five years. And I will hold that record up to any federal regulator or international regulator, for that matter, of going from paper to implementation through the states.

If you think about the unfolding of AIG, could states have had a heads-up with better group monitoring and holding company regulations? So you saw the Solvency Modernization Initiative, of course; the reinsurance issues, the credit for reinsurance; principles-based reserving (PBR); the Own Risk Solvency Assessment (ORSA); and corporate governance annual disclosure, which is still being passed in the states.

It really was a taking stock, if you will. I think Terri Vaughan, the former NAIC CEO, really was brilliant during that period, basically saying, "What a great time for us to improve our system while acknowledging that insurance was not the driver of systemic risk that drove the collapse."

Gallanis: *We also had a conversation in Washington through 2009 and into early 2010 about what the federal financial regulatory system could do better, and that conversation ultimately led*

WE HAD A TIME WHERE PEOPLE REALIZED THE FEDERAL GOVERNMENT NEEDED MORE INSURANCE INFORMATION, AND THAT BLURRED INTO A BELIEF THAT THEY NEEDED REGULATORY AUTHORITY.

THERE IS CERTAINLY VALUE IN GETTING PEOPLE TOGETHER AND TALKING ABOUT THE ISSUES OF THE DAY, THE STRESSES OF THE ECONOMY, AND WHERE WE CAN ALL DO BETTER.

to the Dodd-Frank Act. One big part of the discussion, maybe AIG-driven, was what federal regulatory or oversight role should be established in the insurance space? Were federal policymakers right to believe that at least some level of federal involvement, greater than what had existed previously, was appropriate?

Hamm: My answer would be no in terms of an actual regulatory role. If it's looking at the system and trying to help the states do a better job of monitoring activity, then I don't have an issue with it. But an active role as regulators, no.

Gallanis: *Does FIO have a legitimate role in the insurance regulatory marketplace? And if so, how would you see that role?*

Huff: I see a couple different roles. I think part of the mandate of FIO in Dodd-Frank takes a great deal of flexibility away from the Secretary of the Treasury. For instance, on the international side, Treasury is organized with tremendous international responsibilities, which would be a perfect or could potentially be a perfect place to fold in some of the FIO international responsibilities at the IAIS and otherwise. But instead, the Secretary is restricted and has a different office to handle insurance internationally. In many respects, I think it restricts the flexibility of the Secretary to fulfill that international role.

It's pretty clear that FIO does not have a regulatory role, but there likely is a role for someone in Treasury to have contact with insurance regulators and an ability to speak to the federal government. Now, part of the role of FIO that we haven't seen completely realized—and it may just have been the result of the calendar—was to help coordinate all these touch points with the federal government on insurance. I don't know about you, but I felt a lot of touch points weren't coordinated through Treasury, whether it was the Department of Labor Fiduciary Rule or the Consumer Financial Protection Bureau. It doesn't feel like that role has been completely filled out. This is not being critical of the officeholders. It just hasn't reached that level.

Hamm: Just to dovetail a little bit, if FIO ever has a regulatory role, I wouldn't support that. But if it's done right, FIO or something like that can be very beneficial for the system. It can be a bridge to help the states and the state regulatory system be the best they can be and, in some ways, kind of spur them to get things done when the states aren't as interested in doing it. It can also be a bridge internationally, as John talked about, to make sure that, on the international stage, we're doing the most we can for our industry.

Gallanis: *Let's stay on that international point. Within the last week or so, the so-called covered agreement was fully executed. For U.S. companies and insurance consumers in the United States, is the covered agreement a good thing?*

Huff: Personally, I think it will end up being fine. The clarifying statements that came out of Treasury were very important, and part of that was necessary because of the timing of getting an agreement done before the end of the Obama Administration. But those clarifying statements probably give more comfort to the U.S. industry—they ought to—than anything in the covered agreement relating to group capital.

It's been fully executed, but the implementation will be in the next five years. The area to watch very closely is not only what happens to reinsurance collateral—because we know the ultimate goal is to take it to zero—but where does that counterparty risk charge go in lieu of that collateral? There are a variety of different places for that to go in the regulatory regime.

That will be a robust dialogue. The difference between that dialogue and the covered agreement dialogue is that this dialogue will be in public, and there will be an opportunity for stakeholder engagement. That will be very important, because there will be folks who have strong feelings one way or the other on how that's implemented.

Hamm: My punchline answer would be that the devil is going to be in the details of how it's actually implemented, enforced, etc. The other thing to be mindful of is if there starts to be mission creep and the scope is either directly or indirectly enhanced. I think if either one of those things becomes problematic, you'll see state insurance regulators start to oppose it.

Gallanis: *Without impinging on any confidentiality agreements, what's your take on the value of the Financial Stability Oversight Council, or FSOC, in finding new ways to identify, prevent, or mitigate risks to the financial system and ultimately to the real economy?*

Huff: I think FSOC has the same value, or similar value, as the FSB. There is certainly value in getting people together and talking about the issues of the day, the stresses of the economy, and where we can all do better. And the bully pulpit of calling out individual regulatory agencies on where they can do better in their role of protecting consumers and stabilizing the economy—there's value in that.

I question some of the value in the designation process of the individual entities. If you want to know how strongly I feel about that, go to the search engine on the NAIC website and enter the words "Huff and Prudential." You'll see a whole list of documents I've prepared in that regard.

Hamm: I agree that there's value in FSOC. It's not the designation process. It's the putting together in the same room on a monthly basis all the primary regulators of the financial services sector. That's important.

But having been in that room, like John has, one of the things that surprised me was even though that was one of the primary goals, a lot of the information—the guts of what you'd really want to know when we're talking about an issue that's not your sector responsibility—there were still cards being held close to the vest a number of times.

So if it's going to have that beneficial role, it needs to be such that everyone who's in that room is kind of open kimono, all cards are on the table. Because without that, it just becomes a monthly meeting where you kind of find out half the story, and there's not a lot of value in that.

Gallanis: *FSOC can monitor risks to the financial system both by SIFI designations and through oversight of marketplace activities that might pose risk to the financial system. It seems to have devoted a lot of energy and focus on the non-bank SIFI designation process and non-bank SIFIs—all one of them today—and less on activities that might be systemically risky across a marketplace. Any thoughts on that designation versus activity-focused dichotomy?*

Huff: We're all waiting on the report that will come out of Treasury on their perception of where we may need to go on FSOC. And you know, Roy Woodall, the NAIC, and many other thoughtful folks have weighed in that the activities focus was always the place to start, rather than individual firms and designations.

Incidentally, there's a very comprehensive article out on Risk.net. Adam and I are both quoted in it. It's a London reporter who writes about the activities approach, and it's

TO STAY RELEVANT, INTERNATIONAL GROUPS WILL NOW HAVE TO BE AT A HIGHER LEVEL, LIKE THE INSURANCE CORE PRINCIPLES AT THE IAIS, TO GIVE GUIDANCE AND LET JURISDICTIONS IMPLEMENT THOSE PRINCIPLES THROUGH THEIR OWN REGULATORY REGIMES.

> THE ELIMINATION OF LIFETIME LIMITS, THE ELIMINATION OF ANNUAL LIMITS—SHAME ON US FOR NOT DOING THAT OURSELVES BEFORE THE ACA.

also about the de-designation of AIG and the quagmire that's created with the FSB and the international G-SIIs. It's an interesting article because it goes through all that, but it really centers on the activities approach. The part that interests me is, how will the United States and other markets handle an activities approach?

I use a term in this article: the de-globalization of regulation. We've seen the pendulum swing toward international regulation, where we were going to get some pretty strong mandates, perhaps with Solvency II thrown at all jurisdictions. Now we've seen a swing the other way. And to stay relevant, international groups will now have to be at a higher level, like the insurance core principles at the IAIS, to give guidance and let jurisdictions implement those principles through their own regulatory regimes. And I think it's very important if we go into an activities approach that we're not being told by an international body, "This is the activity that's systemically important. Now go stop it." Because we may want to handle that activity in different ways in different jurisdictions.

Gallanis: *The NAIC and state regulators are deeply concerned about the future of the health insurance markets. With all that's developed in the last few months, days, and even hours, do you hold any hope that some degree of certainty, stability, and reform can be advanced compared to where we are right now?*

Hamm: Not much. If you look at the ACA, whether you're for it or against it, the fundamental problem was that it was passed on a party-line vote. And that allowed all the folks on the other side of the aisle to fight against it tooth and nail. It gave the elected representatives of that party the room to oppose it at all costs.

None of that has changed. It's why Republicans have tried so hard to figure out what the replace would be after the repeal, but that's just as hard to figure out as trying to implement the law in the first place.

What I've been telling people left and right and center is, if you really want to find a solution to this, the solution is pretty close to, not the Graham-Cassidy Bill, but the Cassidy-Collins Bill that was floated a couple months before that. For folks in the room who might not remember, that bill basically said, let the states that want to have Obamacare keep it. And the states that don't want to have it, let them opt out of most of it. Other than that, I don't know how you fix the fundamental problem, which is there's never been any buy-in from half the country for the law. I don't know how you fix that.

Huff: Adam and I have been right in the heat of this. I've been followed with video cameras listening to every word I've ever said about the Affordable Care Act. You know, give your state insurance commissioners a break sometimes when they have to deal with things that are politically volatile like the ACA.

Just like the pendulum on de-globalization of regulation, I think we're going to see the pendulum go back to the states. But we really need to be prepared for that.

Let me give you a couple of examples that I don't think any of us in the room could argue about. The elimination of lifetime limits, the elimination of annual limits—shame on us for not doing that ourselves before the ACA. I'll defer to any health actuary who tells me differently, but those are not really drivers that move the needle in terms of overall financial costs. But they can cost a family everything. And shame on us for not doing that ourselves while we had the authority to do it.

We talked about this at lunch, and I said I'm getting whiplash. I can't keep track of who's on first here. At some point, we must have some stabilization. I think the NAIC is trying to give that on a bipartisan basis, with commissioners from both sides of the aisle talking about the cost-sharing reduction payments and other areas where we should be able to find some common ground.

Gallanis: *I know that the NAIC's current president, Ted Nickel, has expressed a deep commitment to finding a proper regulatory role that's related to emerging technology issues and insurance. Are insurance technology advances a blessing or a curse?*

Hamm: They're a blessing, for sure. The question is, how do you handle that blessing from the industry side and regulator side? I think that President Nickel has done a great job in setting up the innovation task force to look at these issues. This year has been all about gathering facts and figuring out what role regulators should have in this area.

["Common Ground" continues on page 26]

Truth Merchants

Gary Hughes and Charlie Richardson discuss the new Administration, the continuing drive for global standards, and the opportunities and risks technology brings

Gary Hughes is the Executive Vice President and Chief Operating Officer for the American Council of Life Insurers (ACLI). Charles T. Richardson is a recently retired partner with the law firm Faegre Baker Daniels.

The following is an edited transcript of our conversation at NOLHGA's 2017 Annual Meeting on October 19.—Peter G. Gallanis

Gallanis: *Just to get started, what's your take on the current state of the political and public policy debate? What's the general political lay of the land, and are things going to get better or worse from where we are now?*

Richardson: I've never seen anything like this. Gary and I discussed yesterday the fact that gridlock continues even though the House, Senate, and White House are in GOP control. That gridlock means that anything occurring, even before the midterm elections, is going to be very, very difficult. The Republicans need a victory on tax reform in the worst way, and that may produce a bill that Gary will talk about later, but it's also possible that it won't.

The President and the Administration are unpredictable. There are unfilled positions not just in Treasury but in other agencies that present problems for those of us dealing with the federal government.

Some of the things being said now are bizarre. I'm older than most of you, perhaps all of you, but last week Larry Flynt took out a full-page ad in *The Washington Post* offering $10 million for information leading to the impeachment and removal from office of Donald J. Trump.

That produces in my gut absolute pain. It is a very unusual situation, and I think it is going to be very difficult for tax reform, certainly infrastructure, even some sort of propping up of Obamacare to happen. It is not a foregone conclusion that there could be progress. Is that too dismal?

Charlie Richardson, Gary Hughes & Peter Gallanis

Hughes: No, I think that's very accurate. To step back a little bit for some perspective on this, I think back to the days when we flirted with the optional federal charter. Back then, I think there was a general feeling that federal regulation was more adept at doing things than the state system. We've come out of the financial crisis, and we see the current Administration—I don't think there's any question that the states are more capable now in dealing with the important issues that confront our industry.

You have an Administration that even close friends of the President are now saying is dysfunctional. There's good rhetoric, but there is extremely poor execution. There are hundreds of senior positions throughout the federal bureaucracy that haven't been filled, where appointees haven't even been selected yet.

What we've seen is that the President can issue all the Executive Orders he wants to various agencies, but if there's no one there to say we need to act on this, nothing changes. We saw that with the Department of Labor and the Fiduciary Rule, where the President issues his Executive Order and there wasn't even a Secretary at the time. The career staff said. "Well, if there's nobody to tell me I can't keep doing what I'm doing, which the previous administration wanted me to do, then I'm just going to keep going." With Secretary Acosta now at the Department of Labor, that's changed a bit.

We had a very interesting meeting with Gary Cohn, who's the head of the National Economic Council, and we were bemoaning the fact that the Department of Labor didn't seem to be heeding the President's Executive Order, and he said, "You're on your own. With this Administration, we've done what we can do. You're worried about the Department of Labor—I've got 10 agencies that have the same problem." Which is, we can't get them to begin doing what this Administration wants done. And whatever that is seems to vary day by day with what the President tweets. So it's a very difficult, almost impossible Administration to get anything done.

Gallanis: *Charlie mentioned tax reform, and Gary, I know the tax treatment of insurance products is very important to your membership. What's your prognosis for the insurance industry regarding the debate about taxes that's going on right now?*

Hughes: This sort of gets to the question of, do people in Washington have a good understanding of our business? And the answer is still no. You may remember when Rep. Dave Camp (R-MO), the former Chairman of the House Ways and Means Committee, came out with the Camp Draft. He came to us and said, "I really think we've done you a favor here." We analyzed the bill, and it was devastating to the industry. He just didn't understand us.

We've spent the better part of two years doing a very effective job educating Senate Finance, House Ways and Means, and general members of Congress on the importance of our industry, of retirement security. We are the safety net, and we can do things that wouldn't be done or wouldn't be done to

This sort of gets to the question of, do people in Washington have a good understanding of our business? And the answer is still no.

the degree people need if left only to the federal government.

The biggest worry in tax reform, as Charlie said, is that you have a Republican Party that's desperate to accomplish something significant before the midterm elections. When politics overtake policy, you're in the danger zone.

Our biggest fear is that people don't understand how the various aspects of tax reform have the potential to affect our business. At the end of the day, they're going to have to raise significant dollars. I think the figure is for every drop of a percentage point in the corporate rate, they need $100 billion over 10 years. So if you're dropping from 35% to 20%, which the House will do, that's a lot of zeros. The Senate's probably going to be a little more realistic, but even at 22% or 23%, they need a whole lot of "pay-fors" if they're going to do significant tax reform.

And I think frankly, if you look at industries, the retailers rose up and beat back the border adjustment idea. People rose up and beat back some of the other ideas that were big ticket items—Affordable Care was going to be a trillion dollars, and that didn't work out. In a way, politically, we're the path of least resistance, and I think that's something we need to worry about.

We have done everything we can do to prepare for seeing actual language, which everything we hear should be the week of November 7. But I don't think anybody is sanguine about the fact that there are going to be elements of it we're not going to like.

Richardson: When the border adjustment tax idea went off the table, that was about $1 trillion. When the Obamacare savings went off the table, I think that was about $1.3 trillion. And we have added to the mix now the bill for hurricane relief. That is another imperative that affects this whole budget mix.

Gallanis: *A big part of the campaign leading to the election of the current President and installation of this Administration had to do with investments in infrastructure. Those types of investments would seem to match up well with the investment objectives of companies in the life and annuity space. Do you see anything happening that could address infrastructure needs and possibly open up investment opportunities for the industry?*

Hughes: I guess it's still a possibility, but for all the reasons Charlie mentioned, how do you pay for this? I think the goal when Trump was first talking about infrastructure was a leveraged trillion-dollar investment. You had to raise maybe $600 or $700 million, and then the leverage would provide the rest. How are you going to pay for it? How are you going to do all the things you mentioned and then lower the tax rates and pay for that?

Most people would say it would be a sweet spot for us, particularly if you're talking about debt financing for this. I was reminding Charlie that when the Build America Bonds came out in 2009, the life insurance industry took down a third of them. We're hungry for quality paper like that, but I'm not optimistic that in the near term anything's going to happen.

Gallanis: *Let me go to a third area, and that's the Department of Labor Fiduciary Rule that was a big objective of the last Administration and a big concern of many in the business community. It was really a broader measure that among other things would make the federal government a business conduct regulator for the insurance industry in ways that pros in the industry thought didn't make a whole lot of sense. There were expectations that with a change in parties in the White House, we'd see some significant relief on that. Is it going to happen?*

Hughes: I hope so. I think a very legitimate criticism of our business has been that consumers don't know which standard of care is being applied to them by the person in front of them. Is it a FINRA suitability standard, is it a Department of Labor fiduciary standard, is it a state suitability standard? And I think people in our industry, the securities industry, and the mutual fund industry feel that there doesn't have to be an identical standard, but there has to be a consistent standard of care.

The Department of Labor, oddly the entity with the narrowest jurisdiction of any of the regulators—FINRA, the SEC, the states—comes up with a rule without really coordinating and consulting with the states or the SEC. People tried, and the Department of Labor was pretty much tone-deaf on that. Labor Secretary Acosta seems to have a better idea of why the current rule is bad—because it really does harm small savers. He is also a stickler for the Administrative Procedure Act. He's not going to do anything in a rash way. He's pretty sure that if he stalls the current rule—and it looks like he will—he's going to be sued by consumer-oriented groups. He's willing to coordinate with the states, the SEC, and FINRA. That's all good.

I think we can make it a lot easier for him if we get a win in our Fifth Circuit case that was argued January 31. You never want to predict outcomes based on how oral arguments went, but the argument went very well. If we could sort of erase the board, then Secretary Acosta, SEC Chair Clayton, the folks at FINRA, and the states could work together and come up with an enhanced standard of care that clarifies the standard that consumers are going to be subject to.

Richardson: We should all remember what Gary just said. I know that many of the companies in this room and our own clients thought when the Trump Administration came in, this sucker was going to go down the toilet immediately. That has not been the case. The Department of Labor has proposed a delay until mid-2019, and the SEC has gotten into the action somewhat. There's litigation in a lot of places, but the most likely place is the Fifth Circuit, and we don't know yet what the result is going to be. For the people who thought this rule would vanish, such be not the case.

Gallanis: *Speaking of carry-over programs instituted during the Obama Administration, after Dodd-Frank was put in place, FSOC and FIO jumped into the insurance world, especially the life and annuity space, with both feet on the theory that life insurer failures could pose material risks to the overall financial system and perhaps even to the general economy. What have FSOC and FIO taught us about the insurance business?*

Hughes: We have one voting member on FSOC, Roy Woodall, who understands insurance. We have state regulators who are present, though they're not voting. They understand. But the lack of simple knowledge of what a life

insurance company balance sheet looks like, how it operates, has been just absolutely stunning. I know MetLife has been beyond frustrated with this whole idea that they're a SIFI because of this run-on-the-bank syndrome.

I could be wrong, but I think we came through one of the greatest recessions since the Great Depression and there wasn't a run on the bank. And the products that they look at as being something akin to demand deposits would be annuities. Well, the guarantees were so far in the money, people would have been foolish if they'd cashed in those products. I think a lot of companies would say please redeem them. But that obviously didn't happen.

When you sit down with these people, they're basically bank regulators, and they say a bond is a bond is a bond. And we're sitting there thinking, "A long-term bond in the hands of a bank presents risk because you have short-term liabilities. But a long-term bond in the hands of a life insurance company matches the long-term liabilities." It took us forever to get some rudimentary understanding of that. And even on the recent vote to de-designate AIG, you still had three members of FSOC that voted against it. They're still hung up on the idea that these organizations are risky.

Richardson: On that, amen, but there was a bright spot there. Chair Yellen voted with the other six, and that's a good sign. The Federal Reserve, the organization one would think is

Our biggest fear is that people don't understand how the various aspects of tax reform have the potential to affect our business.

pushback, not only in the United States but in the UK and elsewhere, against international standard setting. What should we make of the international efforts to supervise insurers or set standards for insurance supervision? Is that still an important issue?

Richardson: It is, and I know there are a whole lot of people in this room, because some of you are our clients, who are irritated when I say these work streams are continuing and they are continuing with input from the NAIC and others. There are conversations going on about resolution—we're awaiting resolution-related output from both the IAIS and the FSB. Peter addressed last month in Basel a workshop designed to talk exclusively about resolution.

These conversations are going on, and I do not believe they're going to end because of the attitude of the Department of Treasury or the Federal Reserve or the SEC saying that they ought to end. This is a freight train that continues, although moving more slowly than in the past. Do you agree?

Hughes: I do, and I think part of what's happening is sort of what we call Team USA. If you look back at the crisis and which countries came through that crisis better than most and what segments of the industry did, insurance came through the crisis very well. And it's been frustrating to see the IAIS try to drive a Solvency II concept and say, "We've got it figured out, we have the right way," when in fact state insurance regulation acquitted itself very well. Maybe that should be the model the rest of the world looks at. I know that's been frustrating for our regulators, and hopefully we can push back on that front because it makes sense to do so.

Richardson: Don't kid yourself. Resolution is in play over the next 12 months. This is an issue that perhaps went a little more slowly in 2015, even into 2016, but now it appears to be full throttle.

Gallanis: *So the world is changing. One of the ways in which it's changing is that we have a mature industry in the life and annuity space trying to sell its products to younger generations—Millennials, Gen-Xers. And those people don't want to spend three hours at the kitchen table with a career life insurance agent.*

the most impacted by the FSOC process in terms of territory and turf, voted with the majority. That's a bright spot.

Gallanis: *President Trump has asked Treasury Secretary Mnuchin and his team to do a soup to nuts examination of the financial services regulatory landscape, including insurance. What does the industry expect to come out of this review?*

Richardson: The recommendations we are seeing pursuant to all the Executive Orders and the Presidential Memoranda indicate that the suggestions that are going to be made are going to be more incremental than we probably all thought in January. I think there will be more suggestions, at least on the bank side for community banks, that are small in nature and incremental. On insurance, they are going to speak about the FSOC process and the fact that there's less reason for more federal regulation in insurance. I would expect them to be supportive of state regulation.

There is one footnote that we should talk about. There is a progressive streak within the bosom of our President and his advisors that may cause them to make some suggestions we might not like.

Hughes: I think you're right on all those points, and then it gets down to the thing we talked about before—rhetoric versus execution. What will come of the good and maybe some of the less-desirable recommendations?

Gallanis: *Regulators around the world, initially at the urging of U.S. federal regulators, developed the idea that having standards for financial supervision that were consistent and comparable around the world would be a good thing. Now there seems to be a*

We came through one of the **greatest recessions since the Great Depression** and there wasn't a run on the bank.

They want to shop online. How is the industry making plans to sell to people who look at the world differently than traditional buyers?

Hughes: I would say, more slowly than anybody would like. Millennials are the biggest demographic in this country, and the philosophy really is, if I can't do it in three clicks, I'll just move on to some other purchase decision. Predictive analytics, blockchain, things like that—companies are going to have to embrace those things, see how they can make things work in a more streamlined, simplified matter.

An interesting issue is the complexity of our products and whether that lends itself to the marketplace of the 21st Century. We had about four of the major annuity writers come in and talk to ACLI staff to explain the annuity business. When the last of them left, we were sitting around the table and somebody said, "Did you have as hard a time understanding that as I did?" I felt the same way. I had a hard time understanding what our member companies were telling us about the annuity business.

I hear CEOs say all the time, I don't want to see my business commoditized. On the other hand, the very same people are saying we really need to simplify our process, our underwriting, so that you can do it in three clicks. I don't know how those two things mesh. To me they seem almost inconsistent.

I think one of the biggest challenges for our business, on a lot of our products, is how can you tailor your product in a way that lends itself to underwriting techniques that we're going to have to embrace and at the same time not simply be a commodity where people shop on price alone? It's a challenge.

Gallanis: *You mentioned that a big part of the strategy is increased reliance on electronic avenues of selling. But we heard from Adam Hamm yesterday that in the minds of a lot of people who do risk evaluation for the industry, technology poses both the greatest opportunity and the greatest risks. Is the industry up to speed in terms of preparing for and guarding against those risks?*

Richardson: The whole question of big data is a gigantic issue for the industry and regulators. Regulators are trying to understand how insurers use data—not only in underwriting but in claims handling and ratings—and that is going to get into the life and annuity space. It's not going to be restricted to property/casualty.

NAIC President Nickel said at the InsureTech Connect Conference two weeks ago, from a regulator's perspective you need to understand how things work. Your mind goes to dark places when you don't understand. And the NAIC's big data committee is hard at work trying to understand all of this because it is a very, very significant economic and legal issue.

Hughes: I agree. At our recent annual conference, we had a session on blockchain. A reinsurer put up a slide that said, here are 15 or so areas where we're looking at how blockchain could streamline our business. And if you looked at them, almost every one of them had a regulatory challenge attached to it. Companies can be forward thinking, but regulators are going to have to be forward thinking as well.

Richardson: Our clients are trying desperately to understand the implications of all these algorithms, not only because they offer opportunity, but because they also offer—from a regulatory and class-action standpoint—big risk.

Gallanis: *Charlie, you've asked for the last three minutes of this annual meeting to bring us home.*

Richardson: If you look at the "Making Insurance Great Again" slide, these are the four imperatives that we have talked about, not just in the education project that has been front and center with this system over the last 10 years, but in other elements as well. We've talked a lot about that second one, industry coordination and being a truth merchant on and off the Hill on all things policyholder protection and what all of you do, day in and day out.

I demand that these four imperatives—particularly that second one, which is at the heart of what you two do every day—be front and center for all of us. Please remember, my grandfather lived to 108. If you do not follow these four imperatives, I shall come back and smite thee.

Making Insurance Great Again

- Protecting/insulating the guaranty system from attack and improving its resilience and adaptability to a changing world
- Industry coordination and being a "truth merchant" on and off the Hill on all things policyholder protection and resolution
- New receiver/guaranty association cooperation on R-FAWG, RITF, and other NAIC initiatives
- Carefulness and resourcefulness as Congress debates Dodd-Frank changes in 2018 and beyond

["Looking Back & Looking Forward" continues from page 1]

The Trump Era: Times have changed, and our priorities must change with them. I'll discuss our focus for the future in the section on making insurance great again—no peeking.

What a Difference a Decade Makes

In short, the insurance industry has been through a transformation of sorts. Ten years ago, prior to the Great Recession, insurance regulation resided with the states, with limited involvement by the federal government (except on taxes) and no significant interaction with international standard-setting bodies. When it came to insolvencies, state receivers and the guaranty system could go about their business, quietly taking care of policyholders without worrying that much about what was happening in Washington or Basel.

That all changed with the financial crisis. Now federal and international policymakers are concerned about financial stability, and that concern extends to the insurance industry. To safeguard the financial system, there has been a real focus on group supervision, enhanced capital standards, resolution and policyholder protection, and living wills. For its part, the NAIC has sought to modernize the state-based system of solvency regulation and has been compelled to work with federal and international policymakers like never before.

Whether the action is playing out at the federal level, internationally, or at the NAIC, it's often the same people in the room helping to shape the outcome. The Fed, FIO, and the IAIS regularly send representatives to NAIC meetings. The NAIC, Fed, and FIO all are members of the IAIS, with FIO playing a leading role in the development of international capital standards.

In and out of Congress and state, federal, and international bodies, there has been a move away from a singular focus on policyholder protection toward a dual focus on policyholder protection and financial stability. That's why we're seeing capital standards and resolution strategies aimed at minimizing the impact of a company's failure on the broader financial system.

It's in that vein that the mild inquiries about the guaranty system and how it works have now become a laser focus on how we do our job, whether we can do our job well if there is another AIG-sized event, and simply how durable we are in today's economic environment. We continue to field questions about guaranty system capacity and our ability to handle the failure of a major insurance company.

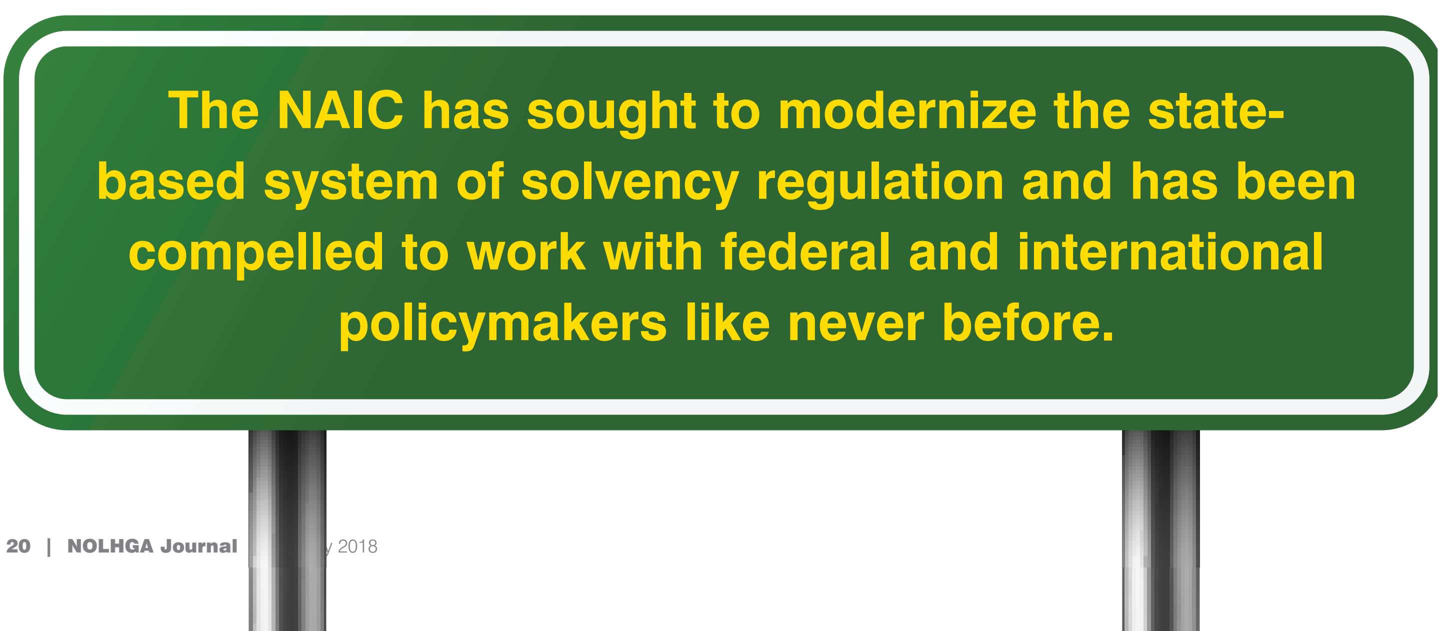
Some policymakers don't want to hear about our track record; their focus is largely driven by a set of bank-centric "run" assumptions not grounded in any historical insurance experience. This bank-centric mindset ignores the low probability of a major insurer failure and what would have to develop in the general economy for that risk to materialize. Still, there is room for the guaranty system to develop better the case that it has the operational and financial capacity to deal with hypothetical major insurer failures, and that work is progressing. The U.S. guaranty system must continue to look and act like the unified, national system it has become.

NOLHGA and the NCIGF have had a federal education project since well before the enactment of Dodd-Frank, and Presidents Peter Gallanis and Roger Schmelzer have been on the front lines every step of the way. In furtherance of the project, the guaranty system and its representatives interact regularly with Congress, the Fed, FIO, the FDIC, major trade associations, and the NAIC. These key players now have a better understanding of the important role played by the guaranty system and an appreciation for the valuable expertise that the system has developed and deployed. But getting them there has not always been easy—and we cannot say there is a perfect appreciation for the guaranty system across all constituencies.

MIGA

But that's past. What's next in the quest to make insurance great again? Here are my four essentials:

- Protecting/insulating the guaranty system from attack and improving its resilience and adaptability to a changing world
- Industry coordination and being a "truth merchant" on and off the Hill on all things policyholder protection and resolution
- New receiver/guaranty association cooperation on R-FAWG, RITF, and other NAIC initiatives



The mild inquiries about the guaranty system and how it works have now become a laser focus on how we do our job, whether we can do our job well if there is another AIG-sized event, and simply how durable we are in today's economic environment.

- Carefulness and resourcefulness as Congress debates Dodd-Frank changes in 2018 and beyond

These are the four imperatives that NOLHGA's Financial Services Modernization Committee and the NOLHGA Board have made sure are never far from the brains of Peter Gallanis and everyone reading this article. And so it must be from now on. We absolutely must do these four things to protect the guaranty system and the consumers it protects. The second imperative may be as important as the rest—staying in sync with the ACLI and its industry members, along with the health industry trades and their members, as we together move forward in a new world.

Our industry is subject to all the demographic trends buffeting the economy generally: the millennials and how they buy; big data, privacy, and security; long-term care and retirement security. We have to stay nimble and adaptable, and that's certainly true as we strengthen and protect the guaranty system and its mission. The best thing for the guaranty system is the stability and growth of all parts of the industry, which the companies and their trades are working to strengthen every single day.

Obviously, we must stay current with the Administration and the leadership of both the House Financial Services Committee and the Senate Banking Committee to ensure positive developments and that federal public policy flows from an accurate understanding of the guaranty system and its benefits. The electoral earthquake in November 2016 accelerated that imperative in the GOP-controlled Congress and Trump Administration.

We also need to guard against complacency. The main lesson we've learned over the past decade is the importance of continuous engagement. By staying in frequent communication with regulators, policymakers, and the trades, our chances of being consulted on matters we care about improve, and the risk that decisions will be made about us without consulting facts decreases. Again, Dodd-Frank is going to be debated in the Republican-controlled federal government. For this reason, we must be accessible so that decision makers are looking at reality rather than a mirage when it comes to guaranty system issues.

In short, when it comes to resolution and policyholder protection, NOLHGA has the facts and the information that policymakers need and that thought leaders should consider when important issues arise.

Let me conclude by reminding everyone that language matters. Words live on. Arguments have impact. To make sure NOLHGA has the rhetorical tools to face the future I've just described, I leave you with these Richardson-isms (below). Use them and you'll be fine even without me in person. Just fine. ✪

Charles T. Richardson is a recently retired partner with Faegre Baker Daniels.

["President's Column" continues from page 3]

Congress and elsewhere over the perceived inability of the state system to do the fundamental jobs of monitoring solvency and protecting consumers.

If you're only familiar with the debates over federal regulation and the optional federal charter that took place in the early 2000s, it might surprise you to learn how close we were to having a federal insurance regulator, even a decade earlier — a close call, but one of at least four such close calls in my professional lifetime.

Now, one other thing we learned is that this sort of pressure can have a beneficial effect. Iron sharpens iron, as the saying goes, and the intense scrutiny that state regulation underwent prompted the NAIC in the mid-1990s to improve significantly the way its members monitor solvency.

Number 7: ELIC

I could do a Top 10 List of lessons learned in ELIC alone, but I'll limit myself to noting that ELIC showed us, more than any insolvency before and as much as any since, that high-profile—or notorious—insolvencies have a tendency to bring to the fore political considerations. This is especially true in states where insurance commissioners are elected, though it is by no means limited to those states.

In ELIC, we saw a recurring tendency on the part of the domiciliary commissioner (who was also the receiver) to consider political ramifications of his decisions—sometimes to the detriment of policyholder interests, let alone unnecessarily high resolution costs passed on to our member companies, their owners and policyholders, and taxpayers.

When the receiver's main focus is, "What will be the headline in tomorrow's *Sacramento Bee*?", it undermines efforts for an effective resolution. And when this occurs, we need to be prepared to respond to efforts to politicize resolution decisions by calmly but factually focusing on the important issues, and by communicating with relevant stakeholders.

The bottom line is that extraneous political considerations can and will influence large cases. But we can't be taken by surprise, and we need to be prepared to deploy all our best arguments about doing the right thing instead.

Number 6: Mutual Benefit & Confederation Life

Take everything I just said about ELIC, flip it, and you'll have a good sense of the experience we had with Mutual Benefit and Confed Life. These were no-nonsense, get-the-job-done-right insolvencies, and they serve as a welcome reminder of what can be accomplished when you have top-flight professionals making decisions based on facts rather than sound-bite politics.

What was accomplished? Thanks to the hard work of the guaranty associations, regulators, and the industry—there's that industry involvement that I mentioned earlier—policyholders were covered at 100 cents on the dollar in a way that reduced the cost to our member insurers to almost nothing. These resolutions were cases that should be a great source of pride for members of this system. I could write a book, but since others already have, let's move on to...

Number 5: Thunor Trust, National Heritage & Lincoln Memorial

We come now to Thunor Trust. A little background here. I had been on the job at NOLHGA for about 15 minutes when the phone rang with news of a big mess centered in Greenwich, Connecticut, and Birmingham, Alabama. At this time, we didn't know that the Vatican would soon be involved.

That's not a joke. The Vatican. Ask Frank O'Loughlin to tell you that story.

By the end of that weekend, a succession of stories broke about Marty Frankel and the companies he'd pilfered before absconding with millions of dollars and a set of personal habits that would make the writer of *Pulp Fiction* blush. For the next six weeks, there were daily front-page stories in *The Wall Street Journal*, *New York Times*, and regional papers all across the country, detailing how Frankel fooled regulators for a time, then disappeared with millions in diamonds, various women, and tales of S&M parties.

But one thing that you did *not* see in all those hundreds of stories was any mention of policyholders suffering losses. Neither did you see stories critical of the guaranty system. *We* weren't the story, and that's because we had an aggressive task force that worked with the various receivers to ensure a seamless transition from rehab to liquidation. No policyholders fell

I'm encouraged by the new relationships we've developed with leading thinkers in the health insurance industry, who are relatively new participants in our system.

Concerns about the 2008 AIG crisis and financial services in general caused policyholders, the media, Congress, academics, and other thought leaders to look at insurance with a degree of concern that hadn't existed before.

through the cracks, because we were there to catch them, and policyholder claims were essentially protected at 100 cents on the dollar.

The question that was posed in cases like Thunor, National Heritage, and Lincoln Memorial—cases in which millions and sometimes hundreds of millions have been stolen—is, what do we do about it, since we're financially responsible for the shortfall?

The answer, which we've learned over time and are applying even today, is that when guaranty associations pool their resources with receivers and recognize that our shared interests are greater than any differences we might have, we can develop an effective and aggressive plan for asset recovery, and we can do some great things to minimize ultimate net resolution costs, even after the policyholders have been fully protected. That's true even when some really smart crooks have done their best to hide the money.

Number 4: ELNY

This is another case in which a lessons learned report could end up looking like Stephen King's *It*, but I want to focus on one simple lesson: Instituting formal or informal receivership proceedings is the beginning of a long and critically important process—it's not an end in itself.

ELNY was placed in rehabilitation in 1991, at the same time the related ELIC proceeding commenced, and a plan of rehabilitation was approved in 1992. After that, it was left to the rehabilitator to execute the plan, and the rehabilitation fell off everyone's radar.

It shouldn't have. A lot of important stakeholders had an interest in the success of that plan, and the plan failed. In hindsight, all of us who dealt with that case realized that, when a rehabilitation involves a long-term runoff of liabilities, there must be regular and transparent accountability for plan performance so that, if something goes off track, people can refocus and reorient the plan and address problems as they emerge, rather than afterwards, when the damage may no longer be remediable.

The ELNY liquidation was a case of closing the barn door after the horse had long bolted. Not only is that a costly way to do things—it also undermines confidence in the state insurance system.

Fortunately, this seems to be another instance where participants in the receivership process are producing positive results from a negative situation. I'm referring here to the creation of the NAIC's Receivership Financial Analysis Working Group, or R-FAWG—largely a reaction to the ELNY disaster—which shows some promise for addressing the types of "orphan runoff" problems that occurred in ELNY.

One other lesson. When you're called on to solve a problem that's been left to fester for this long, putting together a plan to reduce the damage requires a lot of creativity—and significant participation from industry leaders. My column in the October 2017 *NOLHGA Journal*, included in your registration folders, touches on the complexity of the ELNY resolution plan and the creativity of many smart, diligent people who crafted it.

Number 3: The 2008 Financial Crisis

There's a cottage industry of people drawing lessons from the financial crisis, so I'll keep this brief. All of us know the tale of the crisis—hundreds of banks and thrifts failing, thousands of pension plans swamped, all the largest investment banks failing or being acquired, Fannie and Freddie cratering, the rest of it…

And then there's the insurance industry. No major failures, setting aside AIG and the significant anomalous circumstances surrounding the non-insurance activities in that group in 2008 and since eliminated. And unlike the crisis in the 1990s and the unflattering GAO reports, state insurance regulation emerged relatively unscathed. You can say we dodged a bullet, but if so, it wasn't due to luck. All the reform efforts spurred by the 1990s crises, *Wishful Thinking*, and the rest, proved to be remarkably effective, and they helped the insurance sector weather the storm pretty well.

The lesson we might take from this is that, when you put the best minds you've got to work in an effort to improve the system, you can achieve remarkable results.

Another lesson we need to take with us, however, is that concerns about the 2008 AIG crisis and financial services in general caused policyholders, the media, Congress, academics, and other thought leaders to look at insurance with a degree of concern that hadn't existed before. We're on their radar screens, and we're never dropping off again. We need to get used to the attention. Hence the NAIC's Solvency Modernization Initiative that Adam Hamm and John Huff described yesterday, along with so much else that we have elsewhere discussed. Such as…

Number 2: The Dodd-Frank Act

In the wake of the 2008 elections, we certainly had the attention of lawmakers intent on preventing another financial crisis. Anyone who spoke with people on the Hill during the crisis heard from Congress that we needed measures to prevent large insurer failures, or at least put us in a position to deal with them.

Thus we got the provisions for oversight of systemically important companies in Title I of the Dodd-Frank Act, as well as the orderly liquidation authority in Title II, which can extend to insurance groups. You can also chalk up the creation of FIO and the FSOC to this concern, as well as the new oversight roles of the Federal Reserve and the FDIC.

So once again, we learn that, when things go wrong and insurance is mentioned, people take notice. Insurance is no longer the "sleepy little backwater of financial services," as Mike McRaith noted at our Legal Seminar a few months ago; neither is the guaranty system. Any failure, or even a perceived failure, puts us squarely in the crosshairs. Which means that we have an interest in our next item.

Number 1: The Affordable Care Act

The ACA arose out of an entirely different set of concerns than the Dodd-Frank Act, but it too radically changed an entire industry. And because it was such a controversial effort and the subject of much partisanism, it has proven vulnerable to changes in the partisan landscape in Washington, as we continue to see on an almost daily—or even hourly—basis.

The bill transformed the healthcare market, and the ripple effects—CO-OP failures, ACA exchange participant failures, and lawsuits over ACA funding—have had a significant effect on our system.

What lessons does it hold for us? Well, maybe that passing a bill to find out what's in it is a sub-optimal strategy. We can also say that the healthcare landscape is changing on a daily basis, which makes predictions a dicey endeavor. As a system, we're vitally interested in following new developments, involving ourselves in the discussions where appropriate, and making sure that we keep our ties to friends in the industry and elsewhere fresh and effective, so that we can continue to do our jobs as the sands keep shifting.

One other factor to consider: Because of the rash of health insurer failures, health companies began paying attention to the guaranty system more than they ever had done before. That's hardly surprising—writing big checks has a way of getting C-suite attention. And the industry found itself paying a great deal of attention to checks it would soon have to write for one particular company.

I know I promised you a Top 10 List, but this is a NOLHGA meeting, and we are dedicated to providing extra value to our members. So you get one bonus item, no extra charge.

Number 1A: Penn Treaty & the Challenge of Long-Term-Care Insurance

You've already heard a lot about Penn Treaty and the LTC market, so you know that Penn Treaty has led to an in-depth and ongoing discussion among guaranty associations, industry members, and regulators about how the unique product that is LTC works: how it operates, how it's priced, how premium adjustments should be considered by regulators and guaranty associations, how the costs of an LTC insolvency should be more fairly allocated among stakeholders. That includes costs for companies (life, health, and potentially HMOs), guaranty associations, taxpayers, stockholders, and even the policyholders who bought policies from the company that failed.

These discussions are far from over, but I'm encouraged by the new relationships we've developed with leading thinkers in the health insurance industry, who are relatively new participants in our system. I'm also encouraged that we are continuing to apply the lessons that we have learned from past insolvencies. I've mentioned the importance of industry involvement a few times already. For that very reason, we reached out to the health insurers early in the Penn Treaty receivership. We knew that any solution had to include them, as the Penn Treaty resolution plan now manifestly does.

So I'm proud to say that we as a system are paying attention to all these lessons.

I hope we've learned that every insolvency, if not every moment, has the power to teach, if we're wise enough to receive the lessons being offered. Those lessons have real value: Some of the lessons we learned in the very earliest days of NOLHGA are still paying dividends today. It's impossible to know which of the lessons we've learned from Penn Treaty or Lincoln Memorial will prove vital in the next decade or two, but I know that, whatever lessons they are, we will take them to heart.

I know this because I know you.

Being president of NOLHGA has many perks, but the best perk of my job is being part of an organization that is so eager to gain the knowledge it needs to excel. The people in this room are, without exaggeration, some of the best in the world at their professions. But they retain an openness and passion for their work that would put twenty-somethings to shame. Your thirst for excellence—for learning the lessons of our past and bringing them to bear on the challenges today and in our future—is inspiring. That attitude of commitment promises great things for any who look to us for help.

Once again, the state of the guaranty system is strong, and it is an honor to serve as your president. Thank you. ✯

Peter G. Gallanis is President of NOLHGA.

["Southern Hospitality" continues from page 7]

in a constant state of operational readiness on this."

Jane Bagley (Senior Vice President and Corporate Counsel) walked attendees through the "escalated matters" process, which is used when NOLHGA's Policy and Claims Administration (PACA) Working Group and the affected guaranty associations need to be consulted before a decision is made on a claim. Employees are trained to flag these types of complex issues so they can be forwarded to PACA, which can agree or disagree with Penn Treaty's recommendation. "So far, they haven't disagreed," Bagley said. The issue is then forwarded to the affected association for final approval.

Peter Goldstein (LTCG)

In keeping with the project management focus of the company, Robinson explained that Penn Treaty tracks 15 key transactions, including speed of service, quality of service, and customer satisfaction. "It's all about measurement," he said. "If it's important to you, we'll measure it." Each transaction has a target goal, and even if the goal is exceeded, the company works to improve performance in that area.

As a TPA, Penn Treaty has two sets of customers—policyholders and the guaranty associations. Not surprisingly, they track both when measuring customer satisfaction. Among policyholders, the overall satisfaction rate is 95%. Among guaranty associations, 86% said they were "very satisfied" and 14% said they were "somewhat satisfied." That second group should expect a phone call. "Those of you in the 14%," Robinson said, "we're coming after you to find out how we can do better."

All that hard work is paying off, according to Eric Rangen, Chair and President of LTC Re, the reinsurance company established to oversee the orderly runoff of the Penn Treaty/ANIC liquidation on behalf of most of the affected guaranty associations. Speaking of Penn Treaty, Rangen said that "they've been under siege, but they're muscling through that quite well. Bob and his team are continuously looking to improve what they do."

Rangen provided an overview of the new company, which has its operations broken down into several subgroups: the Audit & Risk Committee, Investment Committee, Nominating Committee, Coordination & Strategy Committee, and PACA (mentioned above). He assured attendees that the Board, which is made up of representatives from major medical carriers and the guaranty system, along with one representative each from Blue Cross/Blue Shield and an LTC carrier, "has a vast array of capabilities and skills," including actuarial, operations, claims, investment, and management expertise.

The Board performs detailed oversight over all the activities of the various committees and working groups, Rangen said, and he pointed to the work of PACA as being particularly significant. "This is really when the rubber hits the road," he said. "It's where cash goes out the door."

Rangen also highlighted the benefit of having a diverse Board. "Managed care organizations think differently than the guaranty associations, and we've all had some lessons learned," he said. "Importantly, we are working together to provide the best possible outcome for your policyholders." ✯

Sean M. McKenna is NOLHGA's Director of Communications. All meeting photos by Stello Photography.

The Penn Treaty presentation featured Bob Robinson, Jane Bagley & Sharon Reed

REGULATORS ARE DEALING WITH INSURANCE CODES THAT OFTEN TIMES ARE 40, 50, OR EVEN 60 YEARS OLD.

["Common Ground" continues from page 13]

Frankly, I think this is one of the top two challenges that insurance regulators are going to face over the course of the next few years, because this wave of the industry leveraging more and more technology is not going to stop. And regulators are dealing with insurance codes that oftentimes are 40, 50, or even 60 years old. Pennsylvania's goes back to the Founding Fathers, literally.

All those laws and regulations are built on a very time-intensive, paper-heavy process. Well, that's the opposite of where we're heading. How regulators can get from where they are now to where their codes and their regulations need to be to give them the flexibility to operate in this new paradigm is a massive challenge for insurance regulators to grapple with. But overall, it's a blessing.

Huff: Let me give you a perspective on this, because I think it's important. We have two worlds colliding. We have a lot of technology, a lot of use of data over here. Firms think much of it is proprietary, in the way they approach it, and they don't want to share. I get that.

Then we have the codes that Adam just talked about, which are written in a very antiquated way. The folks who came before us wrote those codes, in large measure, to control regulators—to make sure things are itemized and regulation can only be done a certain way.

At some point, these two worlds have to connect. And I think that going forward, we're going to have to see insurance regulation written in a way that can stand the test of time, so that whatever technological advances occur can go through that framework. But we have a long way to go in that.

Audience Question: *As former regulators, how do you view the process that's going on at the NAIC right now to address issues with assessing for long-term-care insolvencies?*

Hamm: As with most really thorny, complicated issues, the NAIC is doing what it typically does, which is take a long, hard look at all the issues and try to figure out if there's any common ground. Kind of like healthcare, which we talked about a few minutes ago, I'm not sure how that journey ends with a solution that's going to be satisfactory for all sides.

I was an elected commissioner. The two most complicated issues, the ones I heard about constantly from consumers, were health insurance and long-term care. Because of the rate increases. So coming up with a solution to this that gets commissioners to go against that kind of survival instinct of not approving huge rate increases to try to get these legacy blocks back to solvency is going to be very tough. It makes healthcare look easy in some ways.

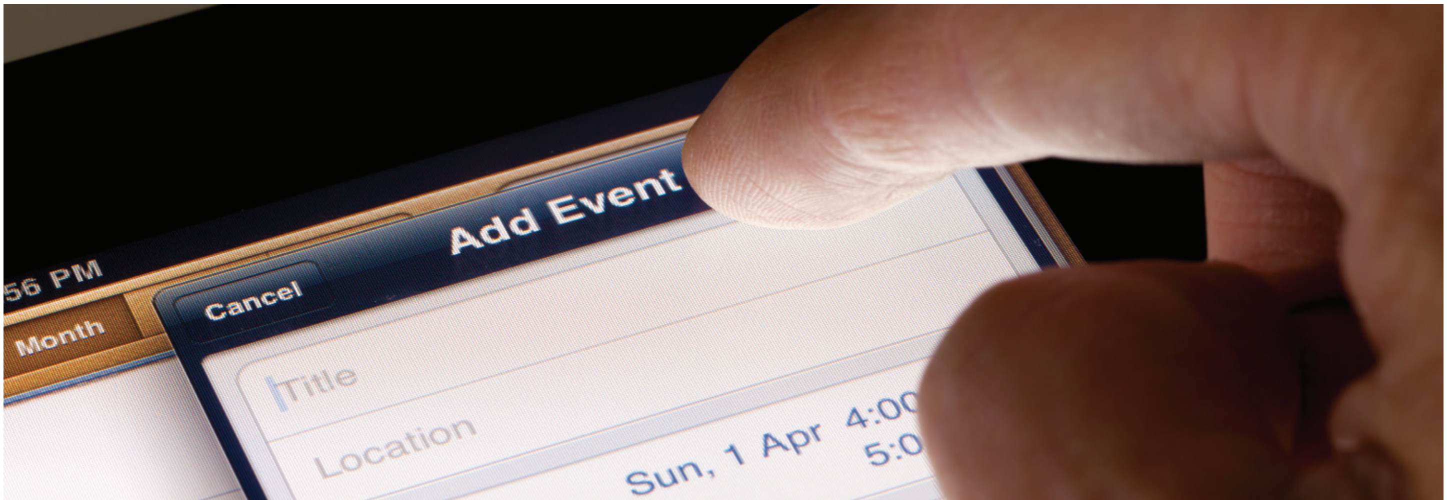
Huff: But it's critically important that we keep talking about it and working forward to find collaboration in the areas where there's common ground. And I'm thrilled there's a larger health crowd here today than we've seen previously. I think continuing that dialogue between the health and life industries is so important.

Peter and I had many conversations last year when I was NAIC President about these issues, and we have to keep talking about them. I think there's no greater risk to our regulatory system than long-term care. It's critical that we get this right. It's not going to be fast, but we have to keep talking about it, and we have to find some common ground. ✯

From the City That Never Sleeps to Sleepless in Seattle!

NOLHGA's 2018 meetings will take you from the Legal Seminar in New York City (July 19–20) to our 35th Annual Meeting in Seattle (October 18–19).

Mark Your Calendar!



NOLHGA Calendar of Events

2018

January 24–25	**MPC Meeting** **Newport Beach, California**
March 24–27	NAIC Spring National Meeting Milwaukee, Wisconsin
April 19–20	**MPC Meeting** **Savannah, Georgia**
July 18	**MPC Meeting** **New York, New York**
July 19–20	**NOLHGA's 26th Legal Seminar** **New York, New York**
August 4–7	NAIC Summer National Meeting Boston, Massachusetts
October 17	**MPC Meeting** **Seattle, Washington**
October 18–19	**NOLHGA's 35th Annual Meeting** **Seattle, Washington**
November 15–18	NAIC Fall National Meeting San Francisco, California

2019

January 8–9	**MPC Meeting** **Bonita Springs, Florida**

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