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A Publication of the National Organization of Life and Health Insurance Guaranty Associations

From All Sides

Insurance regulation is changing on the state, federal, and international levels. Which changes matter the most to the guaranty system?

From the NAIC to FSOC to the IAIS, it's difficult to keep track of all the moving pieces that make up the insurance regulatory landscape. We spoke with Sara Powell and Scott Kosnoff, Partners with the Faegre Baker Daniels law firm who specialize in insurance law, for their thoughts on the future of insurance regulation and which regulatory changes have the potential to affect the guaranty system the most.

***NOLHGA Journal*: How has the regulatory climate become more complicated?**

Powell: Prior to the financial crisis, insurance regulation belonged to the states, with limited involvement by the federal government 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 about what was happening in Washington or Basel.

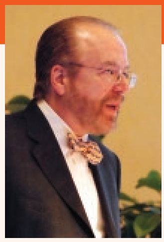
Kosnoff: That all changed with the financial crisis. Now federal and international policymakers are concerned about financial stability, and that concern extends to the insurance industry. In order to safeguard the financial system, there's been a real focus on group supervision, enhanced capital standards, resolution, 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.

Powell: Whether the action is playing out at the federal level, internationally, or at the NAIC, it's often the same people who are in the room, helping to shape the outcome. The Federal Reserve Board, Federal Insurance Office (FIO), and International Association of Insurance Supervisors (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 the international capital standard.

Kosnoff: FIO and the NAIC both participate in the IAIS resolution group. The Fed is a key driver at the Financial

["From All Sides" continues on page 7]

IN THIS ISSUE



Not Your Father's Retirement

Those of us belonging to the "Baby Boomer" generation provide a living connection between the perspectives of the generation of our parents—those growing up in the Great Depression—and of younger people whose frames of reference and experiences are very different from those of our parents.

One area where frames of reference and experiences differ markedly involves the concept of retirement. For my parents and many of their contemporaries, a conventional model was pursued, often successfully. In that model, the family breadwinner (almost always the father) worked for a single company for most of his adult life; he earned a company pension that promised a steady, defined stream of income (in effect, an annuity) to be paid in his retirement years; and often he and his family received health-care benefits from the company even after retirement.

That conventional model now nears extinction, at least for those employed in the private sector. Many people of my generation have worked at multiple jobs over their working life, in part because changes in benefit packages have made the notion of staying with a single company for life less compelling than once may have been the case. Among younger people, few see the likelihood, or perhaps even the desirability, of linking one's career to a single employer for several decades. Many, of course, won't have the choice to stay with a single employer indefinitely.

Employer-sponsored retiree health-care benefits are now rare in the private sector. Moreover, traditional, annuity-style, "defined benefit" (DB) pension plans of the type once so commonly offered by private-sector employers have been disappearing rapidly.

According to the Employee Benefit Research Institute (EBRI), in 1979 about 28% of all U.S. workers looked solely to a DB plan for an employment-based source of retirement security; among workers who had an employment-based retirement plan of some sort in 1979, 62% looked solely to a DB plan. By 2011 (the most recent EBRI figures), only 3% of all U.S. workers looked solely to a DB plan, and among workers who had an employment-based plan, only 7% looked to a DB plan.[1]

Those who follow retirement issues know that the DB trends mentioned above correlate closely to the adoption by Congress of ERISA in 1974. ERISA is a massive body of legislation that has been amended repeatedly since its original passage. It was driven in part by concerns about (A) the failures of several major DB plans in the prior decade; (B) corruption in the administration of some benefit plans; and (C) funding, vesting, reporting, disclosure, and other aspects of DB plans.

Although ERISA does not require employers to establish any sort of pension program, it does (among other things) set standards for the retirement programs that employers elect to provide, including standards for the creation, operation, and termination of such programs. ERISA also established the Pension Benefit Guaranty Corporation (PBGC), which acts as a backstop safety net mechanism when DB plans terminate and do not have the assets required to pay promised benefits.

ERISA also revised requirements for tax-advantaged retirement security programs other than DB plans and various forms of "defined contribution" (DC) plans (which over time have become dominated by "401(k) plans"). In addition, it authorized individuals to establish their own (non-employment-related) Individual Retirement Account (IRA) plans.

The EBRI study mentioned above shows more than just the declining role of DB plans for today's workers. It also illustrates the soaring use of employment-linked retirement vehicles, such as DC plans, that call *not* for an annuity-style defined benefit, but rather a specified contribution from the employer and often the employee, with investment risk (and usually investment responsibilities) borne by the employee and benefits commonly paid as lump-sum distributions.

Looking at the same years considered above, in 1979 only about 7% of all U.S. workers looked solely to a DC plan for an employment-based source of retirement security, and among workers who had an employment-based retirement plan of some sort in 1979, 10% looked solely to a DC plan. By 2011, 31% of all U.S. workers looked solely to a DC plan, and among workers who had an employment-based plan, fully 69% looked to a DC plan. In short, DC plans have almost entirely supplanted DB plans as the preferred mode of employer-sponsored retirement plans.[2]

A subtext of this development is that individuals planning for retirement, unlike their parents or grandparents, are mostly unable to rely upon an employer-sponsored DB plan to take responsibility for a retiree's income security. Rather, today individuals must rely to a great extent on their own efforts and planning to make sure that they will have the income necessary for a comfortable retirement.

Former PBGC Director Gotbaum noted that insurer annuities are far preferable for most plan participants than the alternative de-risking tool, which is to provide participants with a "lump-sum" buyout.

Insurers—and the guaranty system—factor into that paradigm shift in several ways.

First, insurers have been providing annuity contracts since even before the growth of employer-sponsored DB plans following World War I.[3] As non-financial companies (that might be good at making cars, phones, or paper products) increasingly have begun to shy away from the expenses, administrative burdens, and legal and financial risks involved with sponsoring DB plans, they have provided opportunities to life insurers (which specialize in precisely this field) to increase their already-significant support of consumer retirement goals.

In addition to conventional fixed annuities, which life insurers have offered for generations, insurers have also been using variable annuities for the past 50 years to help people accumulate invested assets prior to retirement.

ERISA permits employers that sponsor DB plans to terminate those plans (or to "lift out" some participants from plans that otherwise continue) by purchasing an annuity from a licensed insurance company that provides plan participants the benefits promised by the DB plan at issue.

Increasingly, employers that are not prepared to continue to bear the costs and exposures of maintaining a DB plan have been doing just that, shifting the costs and exposures of DB plans to life insurers providing annuities in "pension de-risking" transactions. As former PBGC Director Josh Gotbaum testified at the 2014 NOLHGA Legal Seminar, such transactions make economic sense both for the company sponsoring the DB plan and for plan participants. In particular, Gotbaum noted that insurer annuities are far preferable for most plan participants than the alternative de-risking tool, which is to provide participants with a "lump-sum" buyout—though current laws and regulations make it easier for sponsors to offer lump sums than to employ insurer annuities. Gotbaum advocated changes to these laws and regulations to facilitate use of insurer annuities rather than lump sums.

Gotbaum's testimony notwithstanding, some pension-rights advocates have questioned whether plan participants are well served when the source of their retirement income is moved from an ERISA-governed, PBGC-protected DB plan to an insurer annuity. Most who have asked that question, however, appear largely unaware of several key factors, including the far greater frequency of DB plan failures than insurer failures; the extensive solvency standards, oversight, and regulation of life insurers; the comprehensive receivership and guaranty association protections available for annuity payees if an annuity insurer does fail; and the significant under-funding problems that have recently confronted the PBGC.

As the subject of retirement income continues to develop and evolve, some people planning for retirement doubtless will find it beneficial to include within their retirement plans some of the more recently developed insurer products, including variable annuities with guaranteed living benefits; single-premium deferred annuities increasingly marketed as "longevity insurance"; contingent deferred annuities; and index-linked variable annuities.

Unlike the retirement paradigm of the past, individuals now planning for retirement must take responsibility for their own financial futures, and they must evaluate choices among increasingly diverse retirement investment vehicles. The U.S. life insurance industry is moving boldly toward becoming an even greater supplier of solid retirement choices. ✯

Peter G. Gallanis is President of NOLHGA.

End Notes

1. EBRI, FAQs *About Benefits – Retirement Issues*, at http://www.ebri.org/publications/benfaq/index.cfm?fa=retfaq14, retrieved May 19, 2015.
2. *Id.*
3. J. Poterba, "The History of Annuities in the United States," National Bureau of Economic Research, April 1997 (Cambridge MA), available at http://www.nber.org/papers/w6001.pdf.

23rd nolhga legal seminar
July 23–24, 2015 | San Francisco

Seminar Snapshot

NOLHGA's 23rd Annual Legal Seminar

Where:	Ritz-Carlton, San Francisco
When:	July 23–24 (MPC meeting on July 21–22)
Program:	The Seminar will run all day on Thursday, July 23, and will end at noon on Friday the 24th.
Website:	**www.nolhga.com/2015LegalSeminar.cfm**
Registration:	$850 (with a $55 "early bird" discount for all registrations received by June 22)
Guest Registration:	$50 for July 22 Welcome Reception $75 for July 23 Luncheon

Confirmed Speakers *(as of June 1, 2015)*

Michael S. Adelberg: FaegreBD Consulting
Merri Baldwin: Rogers Joseph O'Donnell
Deborah Bello: Prudential Financial Inc.
Bob Dell: Latham & Watkins (retired)
John Finston: California Department of Insurance
Victor Fleischer: University of San Diego School of Law
Peter L. Hartt: NJ Department of Banking and Insurance
Mike Kreidler: Washington Insurance Commissioner
George Nichols III: New York Life
Larry Pozner: Reilly Pozner, LLP
Neil Rector: Rector & Associates, Inc.
Daniel Reilly: Reilly Pozner, LLP
Phil Stano: Sutherland Asbill Brennan
Christina Urias: NAIC
Dan Watkins: Law Office of Dan Watkins
Walter Welsh: University of Connecticut School of Law
David Wilson: California Conservation and Liquidation Office

The **Seminars** of **San Francisco**

NOLHGA's 2015 Legal Seminar promises something for everyone

Stop me if you've heard this one before: *About 200 lawyers walk into a hotel in San Francisco…*

If you're familiar with NOLHGA's Legal Seminar, you have heard it before—four years ago, to be exact. That's the last time the Legal Seminar traveled to San Francisco, and it proved to be wildly popular with attendees.

We're aiming to do even better this year as we return to one of our most popular host cities. We're still putting the finishing touches on the speaker program (for a list of confirmed speakers, see page 4), but the preliminary schedule features panel discussions on the most important issues facing the guaranty system and insurance industry, including:

- International regulation and its effect on the U.S. insurance marketplace
- Regulatory modernization, the Dodd-Frank Act, and SIFIs
- New products
- Litigation trends
- The prospects for tax reform and its impact on the insurance industry
- The future of the health-care market
- Cybersecurity
- A Q&A with a key industry leader
- Ethics

In addition to the outstanding speaker program, the 2015 Seminar will also feature a welcome reception on July 22, a luncheon (with guest speaker) on July 23, and an MPC meeting for guaranty association members on July 21–22. See "Seminar Snapshot" on the previous page for registration and guest registration fees (there is no fee to attend the MPC meeting).

But that's not all. Obviously, our host hotel—the Ritz-Carlton, San Francisco, high atop (or almost atop) Nob Hill—and our host city have a lot to offer attendees. The hotel is located in the heart of San Francisco, a few cable car stops from Fisherman's Wharf, Union Square, Chinatown, Ghirardelli Square, and more. And while the speaker program does include an ethics presentation, attendees seeking additional motivation to stay on the right side of the law (or those who want to break out their best Sean Connery impressions) can take a tour of Alcatraz.

From speakers to the host city to its proximity to a former federal prison, NOLHGA's 2015 Legal Seminar is sure to be one of our best yet. If you haven't registered already, please visit the Seminar website (www.nolhga.com/2015LegalSeminar.cfm), where you can also book your hotel room and obtain more information about the meeting. If you have any questions about the Legal Seminar, please contact Meg Melusen at mmelusen@nolhga.com. ✯

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

An Invitation from the Planning Committee Chair

I would personally like to invite you to…

Join Us in San Francisco!

The 23rd Annual NOLHGA Legal Seminar will be held on July 23–24. In addition to the outstanding seminar we have planned for you, you will have the opportunity to spend terrific quality time in one of America's greatest cities.

NOLHGA's Legal Seminar has become recognized for providing top-tier speakers on topics of both general and specific interests. We are well underway in developing a program that covers timely topics such as cybersecurity, health-care market developments, international issues, and many other areas directly on point for guaranty associations and the insurance industry. As usual, there will be a great keynote luncheon speaker on the seminar's first day who will certainly widen our experience and challenge our thinking.

Top 10 Reasons to Attend the 2015 NOLHGA Legal Seminar

1. Experience top-notch speakers who are at the cutting edge in their fields, all of which are presented with the legal perspective of the guaranty system in mind.
2. Enjoy the gathering of nearly 200 of your peers.
3. Trek the Nob Hill neighborhood, shop at Union Square, or dine in Chinatown or Fisherman's Wharf.
4. Earn continuing education and ethics credits.
5. Benefit from the high quality-to-cost-ratio program.
6. Participate in the fast-paced presentations.
7. Relax at the iconic San Francisco, Ritz-Carlton, a Condé Nast 2015 Top Ten Business Hotel.
8. Get pulled out of your comfort zone with a great luncheon speaker.
9. Explore the greater San Francisco Bay or Napa Valley before or after the seminar.
10. Treat yourself to a most productive business/educational experience.
11. (Bonus) IT WILL BE FUN!

I hope you will join us, and I look forward to seeing you at the 2015 NOLHGA Legal Seminar in San Francisco.

All the best!
Tom Sullivan
NOLHGA Legal Seminar Planning Committee Chair

["From All Sides" continues from page 1]

Stability Board (FSB), which designates global systemically important insurers, or G-SIIs; establishes resolution standards; and is the impetus behind the international capital standard. FIO is a member of the FSB's resolution group. It's like a progressive dinner, and the insurance industry is on the menu.

Powell: Not surprisingly, we're seeing NAIC initiatives that clearly are influenced by federal and international activities. Changes in the holding company act, the growing importance of supervisory colleges, and consideration of a living will requirement for non-SIFIs all have their roots in what's happening at the federal or international levels. And now the Receivership Model Law (E) Working Group is analyzing how the state receivership system stacks up against the FSB's Key Attributes of Effective Resolution Regimes.

***NOLHGA Journal*: So much is happening with respect to capital standards, both internationally and at the Federal Reserve. Is that something we should care about?**

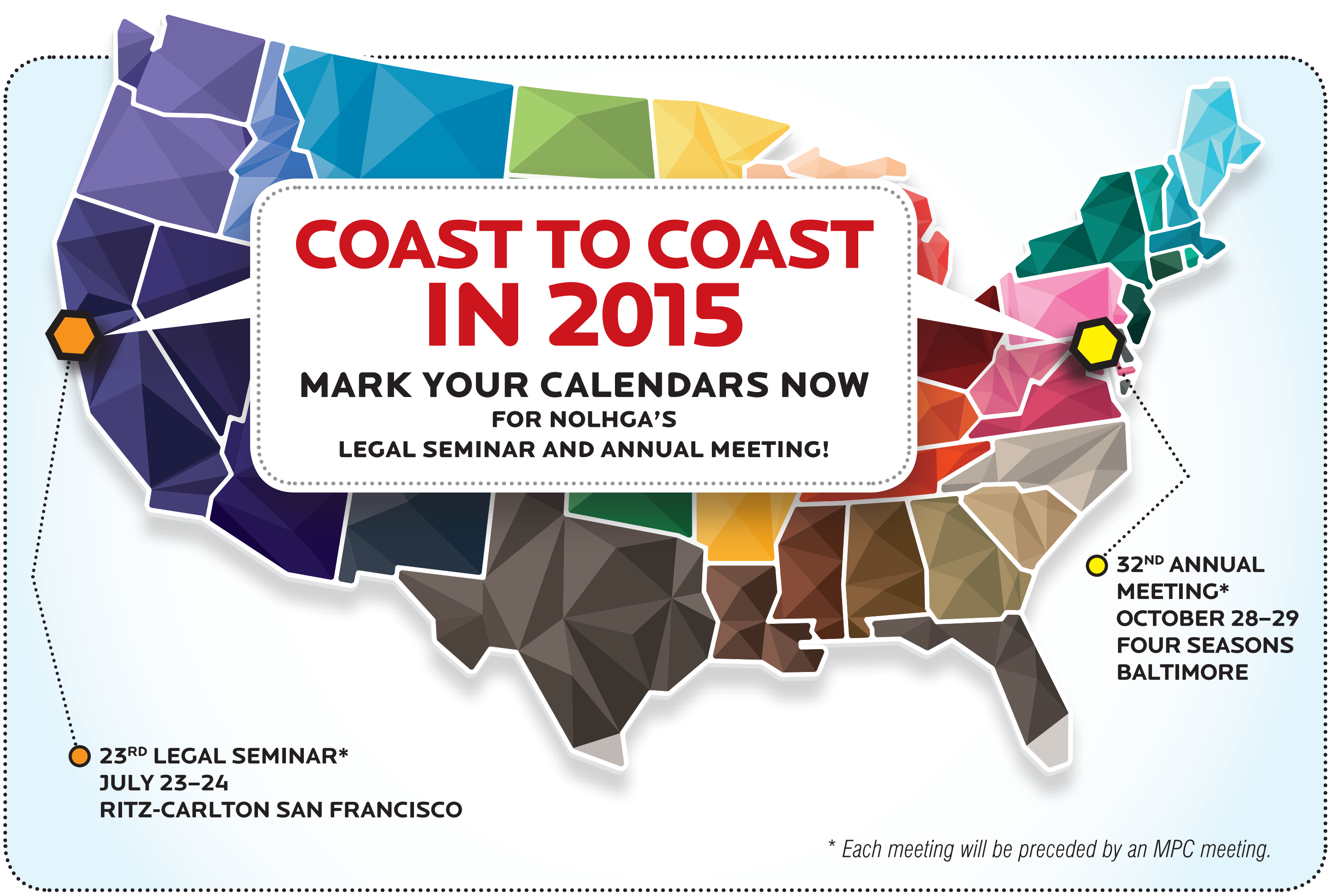
Kosnoff: Yes, at least at a high level. It's easy to assume that capital standards and resolution matters are distinct topics, but they're actually very closely related. Capital standards are intended to lessen the chances that an entity will fail, while resolution strategies are intended to ensure that a failure won't destabilize the economy.

How much capital an entity needs is, in part, driven by how it would be resolved. And how an entity can be resolved depends, in part, on how much capital it has.

Powell: That's why we've been following what's happening with the international capital standard and meeting with the Federal Reserve Board. In a nutshell, some of the decisions that are being made with respect to capital standards could impact the guaranty system—because they will dictate what resolution strategies are possible and what role the guaranty system would play.

***NOLHGA Journal*: Given the new regulatory climate you mentioned earlier, has the goal of regulation itself changed?**

Kosnoff: In part. There's 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.

Powell: It's also why Tom Sullivan, the Federal Reserve's insurance expert, has stated that his primary focus is not policyholder protection, and that he has to focus on financial stability first.

***NOLHGA Journal*: In addition to the new focus on financial stability, what else about the regulatory environment has changed?**

Powell: One big change is the prominent role being played by banking regulators, who have bank-centric experience, perspectives, and concerns. We are seeing this at the federal level with the Fed, the FDIC, and the Financial Stability Oversight Council (FSOC). We're also seeing this internationally at the FSB. And despite protests by the insurance industry and insurance regulators that "insurance is not banking," these bodies continue to view insurance through a banking lens.

Kosnoff: That's exactly right. A majority of the FSOC's voting members apparently are convinced that insurers are subject to a "run on the bank" scenario in which policyholders concerned about their insurer's financial condition will surrender their products and demand their money all at the same time. There's also a fear that if one insurer fails, policyholders of other insurers will engage in the same type of surrender activity, possibly leading to a wave of failures. These bank-centric concerns, in the view of the majority of voting FSOC members, provided a basis for designating Prudential and MetLife as systemically important. The voting independent member with insurance expertise, Roy Woodall, along with the non-voting NAIC representatives and former FHFA director Ed DeMarco, have all dissented from that view in SIFI designation determinations.

***NOLHGA Journal*: How important is it that the guaranty system consider the views expressed by federal and international policymakers?**

Kosnoff: It's very important. We continue to get questions about guaranty system capacity and our ability to handle the failure of a major insurance com-

A majority of the FSOC's voting members apparently are convinced that insurers are subject to a "run on the bank" scenario.

Kosnoff

pany. 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, and it 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 better develop the case that it has the operational and financial capacity to deal with hypothetical major insurer failures, and that work is progressing.

Powell: It's also important that the U.S. guaranty system continue to look and act like a unified, national system. When the FSOC designated MetLife a SIFI, it implied that because a MetLife insolvency would involve multiple guaranty associations subject to varying state laws, the guaranty system might not be able to deliver the immediate and effective coordination necessary to facilitate an orderly resolution.

***NOLHGA Journal*: Given all the changes you have described, how are we engaging with federal and international regulators, the NAIC, and others?**

Kosnoff: NOLHGA and the NCIGF have had a federal education project since well before enactment of the Dodd-Frank Act, 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 Federal Reserve, 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.

Powell: We talk regularly with FIO Director McRaith and his staff. As you know, the guaranty system fared pretty well in FIO's December 2013 modernization report. We were the first outside group to confer with FIO about its recommendations, and we think we are in pretty good shape on the uniformity and other suggestions that FIO made.

In addition to the modernization report, we are in frequent communication with FIO regarding the guaranty system's role in insurance resolutions; the FDIC's "single point of entry" (SPOE) strategy; and FIO's participation in international matters, including the development of the international capital standard and the resolution groups of the FSB and IAIS.

Kosnoff: We have met with the FDIC several times to discuss how its SPOE strategy might apply in the insurance context, most recently on January 20. The SPOE strategy contemplates that a SIFI would be put into a Title II receivership at the holding company level, while all solvent operating subsidiaries would be moved under a bridge financial company and remain in operation. Our main message has been that the SPOE strategy could work in the insurance context if the FDIC, state regulators, and the guaranty system engage in significant coordination/planning and memorialize their respective roles and responsibilities

Some of the decisions that are being made with respect to capital standards could impact the guaranty system—because they will dictate what resolution strategies are possible and what role the guaranty system would play.
Powell

in a written protocol. All of the relevant parties seem to agree on the importance of developing a written protocol, and we're hopeful we'll see some progress on that front in the coming months.

Powell: We have met with the Federal Reserve Board several times to discuss the guaranty system's role in insurance resolutions. Most recently, we met with Tom Sullivan and his team on March 18. The Fed regulates companies that account for about a third of the industry's total written premium. It's hard to overstate the importance of keeping that line of communication open.

Kosnoff: We also coordinate closely with the NAIC on a full range of federal and international matters, including legislation pending before Congress, rules promulgated by the federal agencies, and international standards being considered by the FSB and the IAIS. Most recently, we collaborated with the NAIC on the U.S. response to the International Monetary Fund's Financial Sector Assessment Program (FSAP), which measured how the U.S. insurance insolvency system stacks up against the FSB's Key Attributes of Effective Resolution Regimes. We also worked closely with the NAIC (and the

We're seeing NAIC initiatives that clearly are influenced by federal and international activities.
Powell

Property Casualty Insurers Association of America, or PCI) on the Financial Regulatory Improvement Act.

Powell: Finally, we monitor what's happening at the international level, submitting comments as appropriate, and keep in close communication with our U.S. representatives who participate at the FSB and IAIS. We think we have broadened international perspectives on policyholder protection schemes, although we certainly have a ways to go.

***NOLHGA Journal*: As we look out at the horizon, what should we be concerned about?**

Kosnoff: In spite of past successes, some federal policy makers continue to express concern about guaranty system capacity and possible contagion. This is a primary driver behind the further work being done to demonstrate the capacities of the guaranty system. Nothing will speak to skeptics like data, data, data.

And despite the fact that guaranty associations are established and governed by statute, some federal policymakers think we're too closely aligned with industry. That view sometimes limits how much involvement the guaranty system can have in important policy discussions.

Obviously, we have to stay current with the leadership of both the House Financial Services Committee and the Senate Banking Committee so that nothing happens there that can hurt us. We got an assist when Indiana Senator Joe Donnelly—the only new Democrat to be added to the Senate Banking Committee this session—spoke at the NFI Insurance Summit in March, along with Insurance Subcommittee Chairman Luetkemeyer of House Financial Services.

In spite of past successes, some federal policy makers continue to express concern about guaranty system capacity and possible contagion.

Kosnoff

Powell: What's happening internationally can have a direct impact on the U.S. system of regulation. That point was front and center in the three Congressional hearings held April 28–30.

The potential impact isn't limited to SIFIs. The reason why so many smaller U.S. companies are weighing in on the development of the international capital standard is because they're convinced that, one way or another, it will eventually apply to them.

When the IMF's FSAP report on the U.S. insolvency system is released this summer, we need to be prepared to address any criticisms in short order.

Kosnoff: We also need to guard against complacency. The main lesson we've learned 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 go up. ✪

NOLHGA Calendar of Events

2015

July 21–22	**MPC Meeting** **San Francisco, California**
July 23–24	**NOLHGA's 23rd Legal Seminar** **San Francisco, California**
August 15–18	NAIC Summer National Meeting Chicago, Illinois
October 11–13	ACLI Annual Conference Chicago, Illinois
October 27	**MPC Meeting** **Baltimore, Maryland**
October 28–29	**NOLHGA's 32nd Annual Meeting** **Baltimore, Maryland**
November 19–22	NAIC Fall National Meeting Washington, D.C.

2016

January 20–22	**MPC Meeting** **Clearwater, Florida**
April 19–20	**MPC Meeting** **Newport Beach, California**
July 19–20	**MPC Meeting** **Washington, D.C.**
July 21–22	**NOLHGA's 24th Legal Seminar** **Washington, D.C.**
October 25	**MPC Meeting** **Dallas, Texas**
October 26–27	**NOLHGA's 33rd Annual Meeting** **Dallas, Texas**

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The *NOLHGA Journal* is a publication of the National Organization of Life and Health Insurance Guaranty Associations dedicated to examining issues affecting the life and health insurance guaranty system.

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