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Global Guarantees

A number of international regulatory bodies are studying insurance guaranty mechanisms—what do they have to say, and what could it mean for the U.S. safety net?

By Sara M. Powell

For years, we've been hearing that insurance has become a "global marketplace." What we haven't heard quite as much about—yet—is that as the business of insurance has gone global, so too has insurance regulation. Governments and organizations across the globe are taking a closer look at regulation and so-called "insurance guarantee schemes" or "IGSs."

As we sit here comfortably nestled in the United States, why should we care about what the EU, for example, is saying about IGSs? Here are a few reasons.

The Spillover Effect: Some of the IGS issues being debated mirror debates that have occurred in the United States and so could have a spillover effect. For example, you may recall that *ex post* versus *ex ante* funding of safety net mechanisms was a hot topic during the development of Dodd-Frank and the FDIC's orderly liquidation fund. The bank-centric agencies and legislators that were influencing that discussion were more familiar with (and thus, favored) *ex ante* funding because that is how the FDIC is funded. The United States insurance guaranty system was largely left alone in that debate.

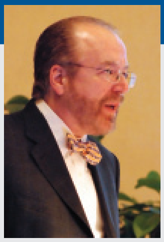
Not so in the international discussions of IGSs. Several key international bodies appear to be advocating for *ex ante* funding of insurance guarantee schemes. While nothing has been decided internationally, U.S. regulators and legislators are paying attention to these debates and could start to buy into some of the arguments supporting *ex ante* funding.

International Coordination: Another IGS issue up for international comment is how to handle safety net coverage for insolvencies of insurers that operate across country lines. Should the insurance guarantee scheme in the domestic country of the insolvent insurer provide policyholder protection? Or should that fall to the IGS of the country in which the policy was issued or where the insured resides? Sound familiar?

As various countries consider how to work cross-border, the United States guaranty system provides an excellent case study. NOLHGA and its member guaranty associations have spent decades refining ways to handle the challenges of coordinating insolvencies that span independent jurisdictions, providing an admirable analog to what international bodies are considering. In fact, NOLHGA and the NCIGF have been discussed favorably in some of the commentaries highlighted below. The systems must remain vigilant to ensure

["Global Guarantees" continues on page 12]

IN THIS ISSUE



Protecting the Consumer: The Aims of Insurance Regulation & the Insurance Insolvency System

"In theory, practice and theory are the same thing. In practice, they're not."
Attributed variously to Albert Einstein and Yogi Berra.

The second quarter of 2012 brought two significant rulings on petitions to liquidate insurers—one in New York and one in Pennsylvania.

In the first case, the New York Superintendent of Financial Services was successful in moving a company from rehabilitation to liquidation, notwithstanding objections from a small group of annuity payees who faced benefit reductions on annuities exceeding guaranty association (GA) limits. In the second, a court denied a petition for liquidation filed by the Pennsylvania Commissioner, instead ordering the Commissioner to work with the insurer's stockholder (who objected to the proposed liquidation) to devise a plan to rehabilitate the company.

In both cases, parties objecting to the liquidation petitions pointed to alleged irregularities in regulatory oversight, arguable flaws in the regulatory system, and the conduct of rehabilitation before liquidation was sought. And in both cases—as in *all* cases where liquidation of a company is sought—the subject companies and various outside parties appear to have missed opportunities that might have affected the course of the receiverships.

Because both cases may involve further appellate or trial court proceedings involving or affecting the guaranty system, it wouldn't be appropriate to discuss the cases in detail.

Nonetheless, these two important decisions present an occasion to step back and review some of the critical questions that confront courts and stakeholders facing significant decisions about deeply troubled companies. For some of these questions, clear consensus answers have emerged from leading regulators and the courts. Are those consensus answers still valid, and can they be defended in today's post-financial crisis, post-Dodd-Frank world? This column examines a few of those questions, the consensus answers that have developed, some issues that may now be revisited, and related implications.

Why Do Insurers Have Their Own Regulatory & Insolvency Resolution Regimes?

What's different about insurance? After all, button shops don't require any special regulation; when they fail, they just go into bankruptcy and their creditors suffer losses, just as with most other businesses. Why is insurance different?

Virtually everyone who has ever written about insurance asserts that the primary objective of insurance law and regulation in general (and insurance insolvency laws specifically) is the protection of policyholders.[1] This special framework of consumer protection is thought to be necessary because selling insurance is different in many ways from selling buttons and other items.

Insurance contracts are inherently complex—consumers often have little understanding of their terms or pricing and little if any power to negotiate either—and the consumer is entirely at the mercy of the company (and the legal and regulatory system) for whether the insurer will have sufficient assets to honor its long-term commitments to consumers when and if those commitments come due: years, decades, or even generations after a consumer buys insurance.

Stated differently, insurance presents a social concern not present in button-selling: the need to provide special and enhanced protections to vulnerable and relatively powerless consumers. This is done through the laws and regulatory system unique to insurance.

While insurers are businesses and corporations, and thus the same *general* set of rules applicable to button shops and other businesses also (mostly) apply to insurers, the *special* provisions of insurance law and regulation have the primary objective of protecting the insurance consumer.

The special provisions inspired by the unique objectives of insurance include a particular set of rules for measuring and regulating solvency; tailor-made rules for the regulation of permissible insurance forms and rates; special and complex asset accounting rules and rules on how to measure and reserve for policy liabilities; a specialized regime for administering insolvency cases when insurers fail; and (of more recent vintage) a financial safety net (the guaranty system) designed to provide some cushion for consumers whose companies fail and must be liquidated.

Our states' laws also give responsibility for managing and overseeing the overall system to highly trained and specialized authorities—Insurance Commissioners, their dedicated professional staff, and the insurance GAs.

Can Insurance Consumer Protection Be Unlimited?

If the over-arching goal of the insurance system is protecting consumers, one might ask: Why does the system need so many complex moving parts? Why not just have someone—say, the government—stand behind any and all insurance consumer promises, whatever those may be?

While we like all promises to be kept, in a capitalist economy the purchase of insurance is still a private financial transaction, entered into between a particular purchaser and a particular insurance company. The insurer's commitment to the consumer involves a specific bundle of promises and a pledge of that company's credit to honor those promises —but not a pledge of the credit of any other company or entity. (Guaranty associations *do* provide an additional level of protection for most consumer insurance products, as discussed below.)

Part of the decision to buy a particular policy involves comparisons of one company to another (financial strength, consumer service reputation, local agents, and so on) and of different products from different companies. Such consumer comparisons of companies and products are generally considered desirable, because this process leads to differentiation, innovation, and competition in price, services, and financial strength.

In any competitive marketplace, some enterprises are more successful than others, and some of the less successful businesses fail. Historically, relatively few insurers have failed, and even fewer of those have been nationally significant companies. Moreover, in the relatively few cases in which insurers have failed, the regulatory system protected most consumers from any losses, and those losses that did occur generally involved very large insurance contracts.

Could a regulatory system protect *all* consumers from *any* losses in the event of insurer failures? In theory, a sovereign state (e.g., the U.S. government) could pledge its general credit to honor any and all insurance obligations in order to provide such protection, but this would create contingent taxpayer liability for expenses that, at least in theory, would be almost unlimited. No such guaranties exist in the fields of banking, securities, or other financial products and services, either in the United States or in any other country of which I am aware, and neither are they available for insurance.

Instead, the U.S. system focuses on preventing insurers from becoming insolvent, providing an insolvency process aimed at maximizing protection for consumers in the rare cases when insurers fail, and delivering a financial safety net system through the GAs that establishes a solid "floor" level of protection for most insurance products purchased by consumers.

If All Insurance Consumers Cannot Always Be Fully Protected Against Losses from Insurer Failures, What Are the Options?

In a system where some businesses (including a few insurers) occasionally fail, but resources for protecting consumers are finite, there are only two real options available to regulators and the courts when an insurer is so deeply troubled that no private parties are willing to come to the rescue by buying or investing in it. One is "liquidation" of the company, which affords policyholders the protection provided by GAs and priority status as claimants against the assets of the company. "Rehabilitation" is the other option. State insurance receivership laws permit use of a rehabilitation plan excusing a company from current performance of certain of its obligations in order to address causes of the company's financial difficulties—but only under certain circumstances consistent with the primary goal of protecting policyholder interests.

Why Are Insurance Companies Liquidated?

Liquidation Generally. Insurance company liquidation is somewhat akin to liquidation under Chapter 7 of the Federal Bankruptcy Code. Insolvent insurance companies are liquidated for the same kind of reasons that bankrupt button makers are liquidated, but also because liquidation is sometimes the best option for assuring the least possible harm to the specially protected class of insurance consumers.

Enterprises generally are liquidated in bankruptcy because their liabilities exceed their assets, or they are unable to pay their debts as they come due, or both. In such circumstances bankruptcy liquidation is considered socially desirable—not-

The preeminent goal of insurance laws and the insurance regulatory system is to protect the contractual promises made to consumers.

withstanding the negative consequences for the bankrupt enterprise—if there is no clear path to continuing the enterprise in a way that is less harmful to its creditors than liquidating it.

Bankruptcy is a type of legal proceeding with substantive rules (about, for example, when a debtor is bankrupt and the relative priority of creditors' claims) and explicit procedures about how creditors' claims may be asserted, proven, and enforced.

The basic, bedrock principles of all insolvency practice include those that creditors should not be required to wait until the debtor is penniless or has depleted *all* of its liquid or healthy assets before those remaining troubled assets are liquidated for the benefit of creditors; that an orderly process for the adjudication of competing creditors' claims is socially preferable to a "race to the carcass;" and that the focus of marginal decision-making is neither on the class of creditors whose claims surely *will* or surely *will not* be paid, but on those whose claims can be affected negatively or positively by the quality of decisions.

Insurance Company Liquidation. Congress carved out insurance companies from the Federal Bankruptcy Code (as it also did for banks), preserving the longstanding state-based insurance company insolvency laws and judicial procedures that focus on protecting insurance consumers ahead of the enterprise's other creditors or shareholders. The laws relating to insurance insolvency, such as the receivership and GA statutes, aim to provide protection to consumers, above all, against adverse consequences from an insurer's failure. To be sure, other "stakeholders" of an insurer—general creditors, managers, stockholders, taxpayers, and others—are also protected by receivership laws; but the preeminent goal of insurance laws and the insurance regulatory system is to protect the contractual promises made to consumers.

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We see the preeminence of this consumer protection goal particularly clearly in state insurance liquidation priority laws, which uniformly provide that claims arising from insurance policies issued by a failed insurer must be paid from the assets of the receivership *in full* before *any* payments to lower-ranking general creditors, or to owners of equity (stock) in the company. This bedrock principal is commonly referred to as the "absolute priority rule."

And while state insurer receivership laws contemplate and permit attempts to "rehabilitate" a troubled insurer, longstanding legal rules hold that a plan of rehabilitation may not seek to protect general creditors, stockholders, senior management, and others if the plan would likely produce a worse economic outcome for policyholder claims than liquidation would. Similarly, rules on "preferential payments" and "avoidable (or fraudulent) transfers" have long protected consumers from the disposition of receivership assets in ways that prejudice some claimants over others in violation of the absolute priority rule.

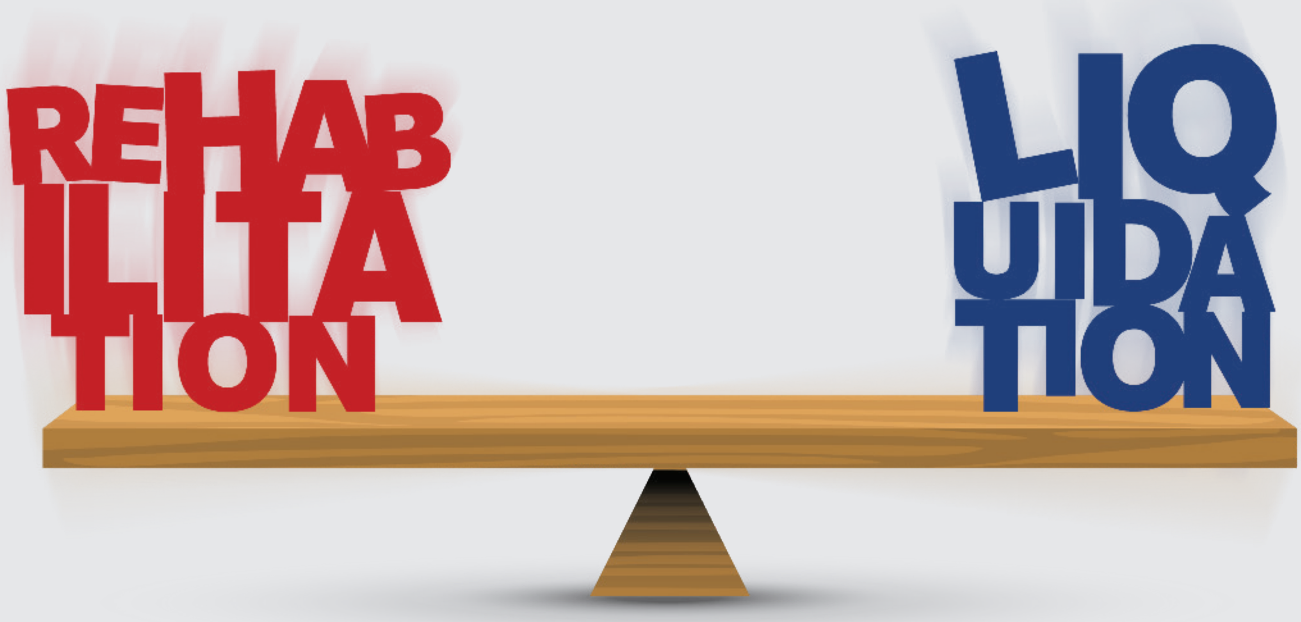
Isn't it Always Better to "Rehabilitate" a Troubled Insurer?

"Rehabilitation" is a term that, in ordinary parlance, suggests a full recovery and return to health, and it sounds essentially innocent and desirable. Notwithstanding common parlance, the term has a technical understanding well known to the insurance insolvency bar.

"Rehabilitation" is a court-supervised form of receivership that may or may not (and certainly *need* not) have as its goal the full return to health of the subject company. Rather, statutorily, rehabilitation need only take steps that the domiciliary (home state) insurance commissioner deems expedient to address the causes and conditions of the receivership.[2]

Substantial case law and practical history suggest that rehabilitation properly may be used—and in fact has been used with considerable success—to address and ameliorate various kinds of financial problems with various kinds of planned outcomes, ranging from resolving all company problems and restoring its pre-rehabilitation status (i.e., returning the company to "the street") to facilitating and optimizing the company's eventual liquidation, expected from the outset.

But there are limitations on the uses of rehabilitation. For example, rehabilitation may *not* be used to produce an outcome that assists some lower-priority stakeholders (i.e., general creditors, senior managers, producers, or equity owners) while providing less protection for insurance policy claims (statutorily preferred claims) than they would have received in liquidation. That point—uniformly established in cases before the U.S. Supreme Court and the highest courts of many leading states—follows logically and inevitably from the overarching



and preeminent goal of protecting the insurance consumer.

Owners and managers of a deeply troubled company often have nothing to lose and much to gain in advocating pursuit of "true" rehabilitation until the bitter end, even if prolonged and fruitless efforts at rehabilitation worsen the ultimate outcome for preferred claims on insurance policies. And indeed, the outcome *can* be worsened in a number of ways: by payments during rehabilitation to lower ranking creditors; by adverse selection in the company's book of business; by diminution in the value of the company's assets; and even by payment in full of insurance claims to those presenting claims during rehabilitation when the company's assets are less than total projected liabilities on all policy claims, including those that would not ripen until after liquidation.

In the banking world, particularly at the start of the bank and thrift crisis of the late 1980s, owners and managers of deeply troubled banks and thrifts sought excessive "regulatory forbearance" from regulators, in many cases pleading to keep the institutions open while they pursued fruitless rehabilitation schemes. The outcome was "deepening" of the institutions' insolvency and the need to rescue their depositors from the resulting damage at an unnecessarily high social cost. Congress subsequently enacted bank regulatory reform legislation requiring "prompt corrective action" to save the public from again bearing the costs of excessive regulatory forbearance. Insurance laws are supposed to operate in the same way.

In short, while rehabilitation can be a proper and helpful tool to address some concerns of some financially troubled insurers, rehabilitation is still a tool rather than an end itself, and it has legal and practical limits. To pursue rehabilitation when it would likely be worse than liquidation in the outcome for claims on direct policies of insurance appears to violate the primary goal of insurance regulation: protecting and enforcing to the greatest degree possible the promise made to the consumer by the insurer.

Policyholders, the Guaranty System & the Rehabilitation/Liquidation Decision

Regulators and courts confronted with the prospect of liquidating a company—particularly when liquidation is opposed by some stakeholders—must make difficult choices in a messy environment, based on imperfect information. Law schools and economics departments study what is theoretically optimal, but in the real world one must make tough decisions to achieve the best practical solution from a menu of more or less unpalatable choices. The old *M*A*S*H* television program called this kind of process "meatball surgery"—doing what needs to be done in the best way practicable when time, information, and resources are all limited.

Decision makers facing such tough choices should weigh some key considerations before reaching their final conclusions.

What Are the Expected Burdens and Benefits for Policy Claimants from Liquidation? When considering liquidation, the regulator should be able to predict (at least within a range) the assets available to address claims, what percentage of policy-level claims can be covered from assets, and (working with the guaranty system) how much GA protection can be provided to policyholders.

Liquidation is obviously bad news for incumbent management of a company, but equating it to imposition of the death penalty, as some incumbent managers have done, is silly. People have an inalienable right to life. Highly regulated companies do not have such an inalienable right to operate; operation is a privilege, which is clearly revocable if the company's solvency—in other words, its ability to fulfill its fundamental contractual promises to consumers—is gone.

Liquidation can do several positive things for policyholders. First, it triggers protection from the guaranty system, assuring that, *at a minimum*, policyholders' claims will be honored to GA coverage limits or "caps." Second, since policyholders whose policy rights (both for present and future claims) exceed the caps also have claims in the insolvency for those "excess-of-cap" claims, the timely liquidation of a deeply troubled company ("prompt corrective action") can prevent further deterioration of the company's assets, maximizing policyholder recoveries on excess-of-cap claims.

What Are the Expected Burdens and Benefits for Policy Claimants from a Hypothetical Rehabilitation Scheme? The key threshold question—both as a legal requirement and as a financial analysis matter—is whether the expected financial outcome for policy-level claims will be as good under a rehabilitation proposal as under liquidation. Only if the answer to that question is "yes" can rehabilitation properly be considered.

Rehabilitation—in some ways analogous to Chapter 11 restructuring under the Federal Bankruptcy Code—permits a company to operate post-receivership, without liquidating (at least initially). A rehabilitation plan may relieve the company of certain burdens it might otherwise have to meet. For example, payment obligations to junior creditors may be reduced, suspended, or eliminated, and even payments on direct insurance obligations may be adjusted *so long as* benefits in respect of policies are not reduced below what could be expected in liquidation.

Writers of life and annuity products have no contractual right to increase premiums prospectively. Some proposals to rehabilitate such insolvent carriers would have "balanced" their books by reducing the insurer's benefit promises to levels below what could have been realized in a liquidation. Such plans have been rejected under the legal standard described above. After all, if insolvency could be addressed by simply erasing liabilities, there would be no insolvencies.

More recently, proposals to rehabilitate certain health insurers (carriers with certain types of contracts classified as "health insurance" that the carrier cannot contractually cancel but for which it can increase rates, subject to local regulatory approval) have been to "balance" the insolvent carriers' books by simply imposing massive prospective rate increases on those policyholders choosing to keep their contracts in force.

No reported court opinion has yet addressed such a rehabilitation proposal, but the concept raises a serious question. Since consumer dollars are fungible, how is the burden on insurance consumers economically different if the plan imposes enormous premium increases or if it imposes enormous benefit reductions? Either step—massive benefit reductions or massive premium increases as a form of "rehabilitation"—appears to violate both the prime goal of insurance regulation (protection of the policyholder) as well as the specific and well-recognized limitation that rehabilitation plans may not leave the policyholder economically worse off than would have been the result in a liquidation.

May a Rehabilitation (or Liquidation) Serve the Interests of Lower-Priority Creditors and Equity Owners? Of course it may. But it seems impossible to square with long-standing law, policy, and regulatory philosophy any proposal to use rehabilitation to protect equity owners, incumbent management, general creditors, or others by schemes that would purport to balance the books of an insolvent insurer on the backs of insurance consumers and leave them worse off than they would have been in a liquidation.

Who Is Primarily Responsible for Deciding between Liquidation and Rehabilitation? In the end, the domiciliary receivership court must make the ruling, but questions remain regarding the nature of the decision-making process. Each U.S. state has a comprehensive system of insurance laws and regulations and invests authority to administer those systems in responsible public officials: Insurance Commissioners and their staffs. Those officials generally develop a high level of expertise and a familiarity with how the interrelated parts of the regulatory system are intended to work. For those reasons and others, receivership courts historically have granted substantial deference to insurance regulators, particularly with respect to technical fact-finding within the realm of the regulator's assigned responsibility.

Are Long-Established Principles Governing Liquidations and Rehabilitations Materially Changed by the Development of a Nationwide Guaranty System over the Past Four Decades? GAs perform two key financial functions in support of the overarching regulatory goal of protecting the insurance consumer: On covered policies, and subject to limits or "caps" of coverage, they protect against both insurers' *credit* failure (insolvency) and a failure in *liquidity*. Before GAs were created in the 1970s and thereafter, consumers were fully at risk both for the degree of the company's insolvency (the shortfall of

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assets vs. liabilities) and for the time it would take an insurance liquidator to reduce the insurer's illiquid assets to cash, evaluate claims, and distribute the cash to claimants. Thus, before GAs, policyholders often waited a long time to receive cents on the dollar for their claims.

The establishment of GAs materially enhanced the protection of consumers when their insurer became insolvent by eliminating those credit and liquidity risks and by continuing the insurance protection under life and health insurance that otherwise would be terminated because of the insurer's insolvency. In all other material respects, the establishment of GAs left unchanged the legal structure and economics of an insurance receivership. Under GA laws in all states, when a GA protects a consumer by immediately providing covered benefits, the GA then steps into the shoes of the consumer as a creditor in the liquidation, to the same extent as the consumer otherwise would have been a creditor. That is, the insolvent insurer owes the same policy claim, in the same amount, as it would if there were no GA. The interposition of the GA between the consumer and the liquidation estate has no effect on the fundamental economics of the receivership, nor on any significant legal analysis. The only distinction—one without a real difference to the obligations to the insolvent insurer—is that a claim otherwise asserted by a covered policyholder is instead asserted by the GA as subrogee.

To be sure, owners of a troubled company, or those who have contributed to its failure, sometimes contend that, because of GA protections to consumers, an insurer failure is akin to a "victimless crime," and that attention need not be paid to honoring all debts owed on policies or to sorting out and enforcing claims against culpable parties.

That contention ignores the fact that liquidations often involve consumers with claims exceeding GA limits, and those consumers maintain very real claims against the remaining assets of the insolvency estate. Furthermore, GA protection is not a "free lunch." Those who ultimately pay the bill for that protection—other insurance consumers, stockholders of healthy insurance companies, and state taxpayers—have as much of a stake in proper receivership outcomes as do the consumers they protect.

Conclusion

An imminent potential failure of a significant insurance company is a highly stressful and confusing situation in which critical and time-sensitive decisions by key actors can easily go awry. No one can make such a challenging burden simple, but decisions are aided by focusing on the key objective of the overall system of insurance regulation: the protection of insurance consumers above all other competing interests. ✯

Peter G. Gallanis is President of NOLHGA.

End Notes

1. This core point is recognized as a matter of hornbook law. See, e.g., U.S. Dep't of Treasury v. Fabe, 508 U.S. 491, 505-06 (1993) (the "primary purpose" of an insurance company is "the payment of claims made against policies"); In re Liquidation of Consol. Mut. Ins. Co., 60 N.Y.2d 1, 11 (1983) ("Although few insurers doing business in New York have become insolvent in the past thirty years, it is impossible to eliminate insolvencies altogether. Where insolvency occurs, however, the policyholder or claimant should not have to bear the loss."); Bell v. Slezak, 812 A.2d 566, 568 (Pa. 2002) (noting "the statute's purpose of avoiding financial loss to the policyholder as a result of the insolvency of an insurer"); AmJur Insurance §112 ("The purpose of the insurance insolvency statutes is to protect policyholders to the fullest extent possible, while shareholders are considered last when assets are distributed.").
2. See, e.g., the applicable provisions of receivership laws in Illinois and Pennsylvania:

Illinois:

§ 215 ILCS 5/192. Duties of Director as rehabilitator; termination. (1) Upon the entry of an order directing rehabilitation, the Director shall immediately proceed to conduct the business of the company and take such steps towards removal of the causes and conditions which have made such proceedings necessary as may be expedient.

Pennsylvania:

§ 221.16. Powers and duties of the rehabilitator -- (b) The rehabilitator may take such action as he deems necessary or expedient to correct the condition or conditions which constituted the grounds for the order of the court to rehabilitate the insurer.

Shipping Up to Boston

NOLHGA's 2012 Legal Seminar heads back to Back Bay

It took the Boston Red Sox 86 years to win a World Series after the team sold Babe Ruth to the New York Yankees. It took the band Boston eight years to produce its third album, the underwhelming *Third Stage*. It's taken NOLHGA only four years to return to Boston, and to Back Bay, for another Legal Seminar. Considering the charms of the host city and the Fairmont Copley Plaza, where the meeting will be held, the decision to return is certainly the right one—unlike getting rid of the Bambino, or inflicting the song "Amanda" on an unsuspecting America.

The program for this year's meeting (see page 11) is the latest in a long line of excellent seminar programs, addressing the most pressing issues facing the guaranty system and the insurance industry. Topics include:

- How the financial crisis affects the insurance industry
- The Supreme Court and the future of health-care reform
- The FIO report and what it could mean for the industry and guaranty system
- International issues and how they might affect the guaranty system and the industry
- The NAIC's Solvency Modernization Initiative
- Key litigation issues facing the industry, including class-action suits
- Tax issues
- Our traditional review of litigation and legislation affecting the guaranty system

Big ideas are paired with big names throughout the program. Johnny Johns, Chairman, President, and CEO of Protective Life Corporation, will sit down with NOLHGA President Peter Gallanis for a discussion of the challenges and opportunities facing the life insurance industry. Susan Voss, Commissioner of the Iowa Insurance Division and Immediate Past President of the NAIC, will participate in a panel presentation on the Affordable Care Act and its likely impact on the health insurance industry.

The court battle over health-care

reform will also be the subject of a presentation by Gregory Katsas (Jones Day) and Neal Katyal (Hogan Lovells), both of whom have argued before the Supreme Court. They'll discuss the court's recent ruling and what it could mean for future attempts to alter the health-care landscape.

The Legal Seminar luncheon will offer attendees more than a great meal—it will feature a speech by the Honorable David M. Walker, founder and CEO of the Comeback America Initiative (CAI) and former Comptroller General of the United States. The CAI promotes fiscal responsibility and sustainability on federal, state, and local levels, and his views on one of the hot-button issues in this year's presidential race are sure to be intriguing.

This year's Legal Seminar Welcome Reception will take things to new heights as we invite attendees to join us 52 stories above Back Bay at the beautiful Top of the Hub and Skywalk (www.topofthehub.net). The reception, which will be held on the evening of July 25, will offer attendees a great chance to mingle with their guaranty association colleagues as they take in breathtaking views of the Boston skyline.

A great program, top-notch speakers, and a fabulous reception are more or less Legal Seminar traditions, but this year's seminar will feature a few new wrinkles. Attendees will have access to free Wi-Fi throughout the seminar, which they can used to download slides or other meeting materials from the meeting materials Web page (www.nolhga.com/2012LSDocs.cfm). They'll also receive USB drives with most of those meeting materials (any files that don't make it onto the drives will be uploaded to the Web page for easy access by all attendees). As a result, attendees won't have to lug around the traditional—and heavy—Legal Seminar binder (but if you really want one, let us know and we'll print one out for you).

Registration for NOLHGA's 2012 Legal Seminar is quick and easy on the meeting Web page, which can be found at www.nolhga.com/2012LegalSeminar.cfm. We'll see you in Boston! ✯

Seminar in Brief

When

July 26 & 27
(an MPC meeting will be held on July 24 & 25)

Where

Fairmont Copley Plaza
Boston, Massachusetts

Reservations

Call 866.540.4417 or book online at www.nolhga.com/2012LegalSeminar.cfm.

Registration

Attendee Registration:	$795 (includes entry to all events and receptions)
Guest Fees:	$50 for the Welcome Reception (July 25) $75 for the Legal Seminar Luncheon (July 26)

Register online at www.nolhga.com/2012LegalSeminar.cfm (NOLHGA accepts Visa and MasterCard)

CLE Credit

CLE credit, including ethics credit, will be applied for in all states that recognize CLE. In past years, attendees have received 8 to 10 hours of CLE credit.

Welcome Reception

The Legal Seminar Welcome Reception will be held on July 25 from 6:00 p.m. to 8:00 p.m. at Boston's beautiful Top of the Hub and Skywalk (www.topofthehub.net). Soaring 52 floors above the Back Bay, the Top of the Hub offers fabulous cuisine and some of Boston's best skyline views. Guest registration is required.

Red Sox

Not in town.

NOLHGA's 2012 Legal Seminar

Preliminary Schedule*

Thursday, July 26

Breakfast .... 7:30 – 8:00

A Welcome to NOLHGA's 20th Annual Legal Seminar .... 8:00 – 8:10
- William P. O'Sullivan: General Counsel, NOLHGA
- James W. Rhodes: Chair, NOLHGA Legal Committee
- Charles D. Gullickson: Chair, NOLHGA Legal Seminar Planning Committee

Remarks by Massachusetts Insurance Commissioner Joseph G. Murphy .... 8:10 – 8:30

A CEO's Perspectives on Challenges, Risks, Opportunities, and the Year Ahead .... 8:30 – 9:30
- John D. Johns: Chairman, President & CEO, Protective Life Corporation
- Interlocutor: Peter G. Gallanis: President, NOLHGA

Regulatory Modernization After Dodd-Frank ... 9:30 – 10:30
- Moderator: Charles T. Richardson: Faegre Baker Daniels, LLP
- Maureen E. Adolf: Prudential Insurance Company of America
- Scott C. Campion: Oliver Wyman
- Thomas M. Glassic: D.C. Department of Insurance, Securities and Banking
- Cynthia L. Martin: Federal Reserve Bank of Boston
- George Nichols III: New York Life Insurance Company

Break .... 10:30 – 10:45

Regulatory Modernization (continued) .... 10:45 – 11:30

Death Lists, Class Actions & Other Hot Topics in Litigation .... 11:30 – 12:15
- Moderator: William P. O'Sullivan: NOLHGA
- Phillip E. Stano: Sutherland, Asbill & Brennan, LLP
- Aaron D. Van Oort: Faegre Baker Daniels, LLP

Lunch/Featured Speaker .... 12:15 – 2:15
- Hon. David M. Walker: Founder and CEO of the Comeback America Initiative and former Comptroller General of the U.S.

PPACA & the Supremes: The Court & Health-Care Reform .... 2:15 – 3:15
- Moderator: Charles D. Gullickson: South Dakota Life & Health Insurance Guaranty Association
- Gregory G. Katsas: Jones Day
- Neal K. Katyal: Hogan Lovells

2014 & Beyond: What Will Health-Care Reform Do to the Health Insurance Market? .... 3:15 – 4:15
- Moderator: Charles D. Gullickson: South Dakota Life & Health Insurance Guaranty Association
- Carl W. Patten Jr.: Florida Blue
- Susan E. Voss: Iowa Insurance Commissioner
- Vincent J. Ventimiglia Jr.: FaegreBD Consulting

Break .... 4:15 – 4:30

Bill & Tad's Excellent Adventure: The Annual GA Legal Roundup .... 4:30 – 5:00
- William P. O'Sullivan: NOLHGA
- James W. Rhodes: Oklahoma Life & Health Insurance Guaranty Association

Friday, July 27

Breakfast .... 7:30 – 8:00

Regulation Without Representation?—International Regulatory Changes & Their Effect on the U.S. .... 8:00 – 9:00
- Moderator: Sara M. Powell: Faegre Baker Daniels, LLP
- Brian K. Atchinson: Physician Insurers Association of America
- A. Thomas Finnell Jr.: Federal Insurance Office
- Leigh Ann Pusey: American Insurance Association

Tax Concerns for the Life Industry in 2012 & Beyond .... 9:00 – 9:30
- Kenneth J. Kies: The Federal Policy Group

Break .... 9:30 – 9:45

In for the Long Haul—Guaranty Association Administration of Covered Obligations .... 9:45 – 11:00
- Moderator: Joel Glover: Rothgerber Johnson & Lyons LLP
- Bart A. Boles: Texas Life & Health Insurance Guaranty Association
- Joni L. Forsythe: NOLHGA
- James R. Mumford: Iowa Insurance Division

Everyday Ethics from Superhero Attorneys .... 11:00 – 12:00
- James E. Daily: Stanford University Hoover Institution's Project on Commercializing Innovation
- Ryan M. Davidson: Hunt Suedhoff Kalamaros LLP

* Subject to Change

["Global Guarantees" continues from page 1]

that they are portrayed favorably and accurately. And to the extent U.S. regulators or legislators believe that international bodies have "built a better mousetrap" when it comes to cross-border resolutions, they may sit up and take notice.

The U.S. Role: Even though this article highlights "international" conversations, this does not mean that they are all occurring outside the purview of the United States. You'll see below that one or more representatives of the United States (or U.S. insurance companies) are members or participants of the key international bodies (such as the IAIS and FSB). U.S. regulators and policymakers are influencing (and being influenced by) the international discussions surrounding insurance policyholder protection schemes.

For these and other reasons, insurance companies and regulators would do well to keep a close eye on regulatory issues outside our borders. What follows is a summary of select regulatory bodies and standard-setting organizations influencing the international discussion of insurance safety net issues. Some of the organizations were formed to focus on insurance-related issues, while others have a cross-sector focus and consider insurance issues in addition to their banking and securities expertise. Because of the breadth and pace of the international financial regulation debate, this summary is not exhaustive, nor is it static.

EUROPEAN INSURANCE AND OCCUPATIONAL PENSIONS AUTHORITY (EIOPA)

EIOPA, formerly known as the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS), is part of the European System of Financial Supervision. This system was created by the European Commission and includes three Supervisory Authorities—EIOPA, the European Banking Authority, and the European Securities and Markets Authority—as well as the European Systemic Risk Board. The objectives of these entities are to solve problems with cross-border firms, prevent the buildup of risks that threaten the stability of the overall system, contribute to the development of a single rulebook, and help restore consumer confidence.

EIOPA is an independent advisory body to the European Parliament, the Council of the European Union, and the European Commission. Its core responsibilities are to support the stability of the financial system; the transparency of markets and financial products; and the protection of insurance policyholders, pension scheme members, and beneficiaries.

Membership

Members include industry representatives, legal experts, and national authorities in the field of insurance and occupational pensions from each member state.

Guarantee Scheme–Related Publications & Key Points

Report on the Cross-Border Cooperation Mechanisms between Insurance Guarantee Schemes in the EU (June 2011)

- Recommends cooperation between and among IGSs and between IGSs and supervisors to ensure that policyholders are protected effectively if an insurer fails.
- Recommends that IGSs gain access to information from insurance supervisors during an insolvency and on an ongoing basis to enable an IGS to prepare for its involvement in potential cases. Highlights the importance of giving early warnings of potential failures to other supervisors and IGSs.
- Discusses the need for confidentiality to facilitate the free exchange of information among IGSs and supervisors.

Exchange of information is a prerequisite for efficient handling of a failure.

- Recommends the development of a mechanism for settling disputes among supervisors and IGSs.
- Provides a detailed (and favorable) description of the insurance guaranty system cooperation mechanisms in place in the United States (NOLHGA and NCIGF).

Task Force on Insurance Guarantee Schemes Mandate (May 2011)

- Will analyze the existing cooperation mechanisms among European IGSs and/or between IGSs and national supervisory authorities with respect to cross-border activities. Analysis will include an examination of the U.S. systems.
- Look into the role of IGSs in the winding up of insolvent companies in member states.

EUROPEAN UNION: EUROPEAN COMMISSION (EC)

The EC drafts proposals for new European laws. It also manages the day-to-day business of implementing EU policies and spending EU funds.

Membership

One Commissioner is appointed by each of the 27 EU countries and is subject to the approval of the European Parliament. The EC's leadership body is selected from the Commissioners and serves for five-year terms.

Guarantee Scheme–Related Publications & Key Points

White Paper on Insurance Guarantee Schemes (July 2010)

- The White Paper seeks to set out a framework for EU action on IGS protection for policyholders and beneficiaries. It recommends action that meets the following goals: (A) ensure comprehensive and even protection for policyholders and beneficiaries, (B) avoid distortions of competition, (C) reduce adverse incentives (prevent taxpayers from ultimately bearing the costs of an insurance company failure), (D) ensure cost efficiency, and (E) enhance market confidence and stability.
- In particular, the White Paper proposes introducing a Directive to ensure that all member states have an IGS that complies with a minimum set of requirements. (There is a common EU framework and minimum standards for deposit guarantee and investor compensation, but not insurance.) This Directive would be binding, requiring member states to achieve the desired result; however, unlike a Regulation, it would allow member states the flexibility to choose their own forms and methods to achieve the result. The White Paper recommends the following minimum standards for any such Directive:
  - Advocates the establishment of an IGS as a last resort mechanism in each member state. (Acknowledges that there is currently insufficient political support for a single EU-wide IGS covering all life and non-life policies written and purchased within the EU.)
  - Advocates harmonizing the geographical scope of IGSs on the basis of the "home country" principle. (See explanation of "home country" and "host country" in "Problems with the European Safety Net?" on page 14.)
  - Advocates that IGSs should cover both life and non-life insurance policies.
  - Advocates that IGSs should cover natural persons and selected legal persons.
  - Advocates that IGSs should be funded on the basis of *ex ante* contributions by insurers, possibly complemented by *ex post* funding arrangements in case of lack of funds, which should be calculated according to the individual risk profiles of the contributors. An appropriate target level for funding should be set, with a suitable transition period. The EC is prepared to consider harmonized compensation limits and other reductions in benefits, provided that appropriate coverage of policyholders and beneficiaries is guaranteed for all relevant classes of insurance and in all member states.
  - Advocates that an IGS should at least, and within a pre-defined period of time, compensate policyholders and beneficiaries for losses when an insurer becomes insolvent. (EC also strongly encourages portfolio transfer where reasonably practicable and justified in terms of costs and benefits.)

EUROPEAN UNION: EUROPEAN PARLIAMENT

The European Parliament is one of the EU's main law-making institutions, along with the Council of the European Union. The European Parliament has three main roles:

- Debating and passing European laws, with the Council
- Scrutinizing other EU institutions, particularly the Commission, to make sure they are working democratically
- Debating and adopting the EU's budget, with the Council

Membership

The European Parliament is the only directly elected EU body and is one of the largest democratic assemblies in the world. Its 754 members are there to represent the EU's 500 million citizens. They are elected once every five years by voters from across the 27 member states.

Guarantee Scheme–Related Publications & Key Points

Resolution on Insurance Guarantee Schemes (adopted by plenary October 13, 2011, in response to EC White Paper—see above)

- Parliament calls on the EC, with regard to the rules and definitions set out in Solvency II and the new supervisory framework, to come forward with proposals for a cross-border standardization Directive establishing a coherent and consistent cross-border framework for IGSs across member states.

- The key elements of an IGS Directive should be the following:

  A. The geographical scope of IGSs should be on the basis of the "home country" principle whereby policies written by an insurer, regardless of location of sale, are covered by the "home" IGS.

  B. The funding model for national IGSs should reflect the home country principle of supervision and the diversity of models used by existing IGSs. The Commission is urged not to advocate a uniquely *ex ante* approach to funding.

  C. IGSs should fully cover valid policy claims across all forms of insurance, and the claims compensation process should provide consistency of consumer experience.

  D. The European framework for IGSs functions as a last resort by providing policyholders (or, where appropriate, beneficiaries) who are eligible with compensation for losses to the fullest possible extent or the possibility of portfolio transfer within a reasonable period of time should an undertaking declare insolvency.

  E. At this stage, IGSs should be limited to natural persons, although individual member states may choose to include legal persons.

  F. Parliament insists that member states should ensure that tests are carried out on their IGSs and that they are informed should the competent authorities detect problems in an insurance company that are likely to give rise to intervention under the relevant scheme, and it suggests that such tests should take place at least every three years.

- EC legislative proposals (proposed Directive) are now expected by the end of 2012/beginning of 2013.

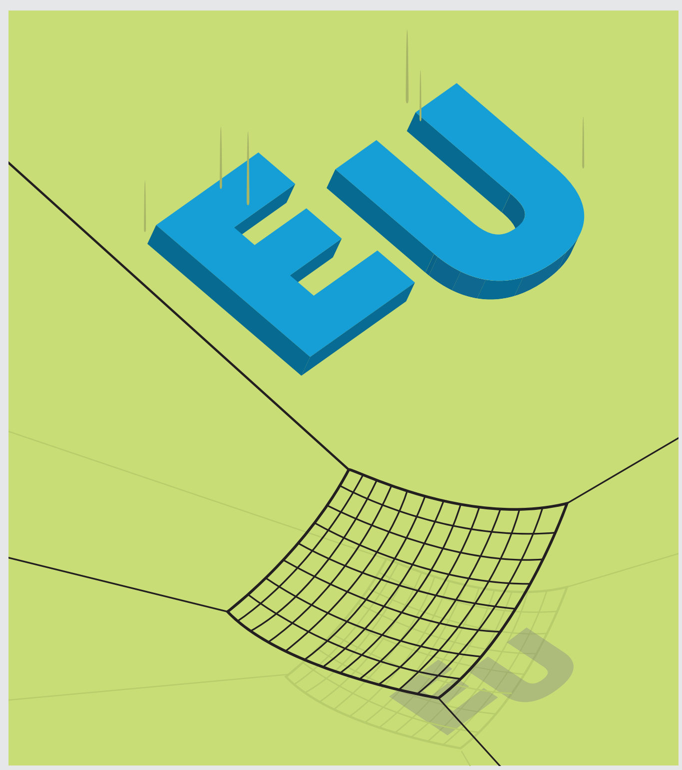
FINANCIAL STABILITY BOARD (FSB)

The FSB was established to coordinate at the international level the work of national financial authorities and international standard-setting bodies to develop and promote the implementation of effec-

Problems with the European Safety Net?

The European Union (EU) has created a single marketplace for insurance, allowing insurers to sell anywhere in the region. Some believe, however, that the "single marketplace" concept is undermined by the differences in insurance guarantee schemes (IGSs) from country to country.

Of the 27 EU countries, only 12 operate 1 or more IGSs (9 states provide life protection, and 7 states provide non-life ("general insurance") coverage). This means 26% of life policies and 56% of non-life policies are unprotected. Additionally, 62% of cross-border life insurance and 23% of cross-border non-life activity in the EU lacks IGS coverage.



There are significant differences in coverage amounts and funding among the national IGSs. Another problematic difference lies in the geographic scope of the coverage offered by an IGS.

Some IGSs provide coverage on a "home country" basis, which means the IGS covers policies issued by domestic insurers, including those written cross-border and those sold by their branches in other EU member states. In other words, the IGS covers the policies of its domestic insurers, no matter where the policies are issued.

Other IGSs provide coverage on a "host country" basis, which means the IGS covers policies issued by the domestic insurer—but NOT those written cross-border—and also covers policies written by incoming branches of insurers in other member states. In other words, the IGS covers only those policies issued within its country's borders, regardless of the domicile of the issuing insurer.

These inconsistent approaches may lead to duplication or gaps in coverage.

tive regulatory, supervisory, and other financial sector policies. Its goals include addressing vulnerabilities affecting financial systems in the interest of global financial security, promoting coordination of information, and monitoring and advising on market developments. It is in the process of identifying global SIFIs, the initial 29 of which were named in November 2011.

Membership

The FSB's membership includes national and regional financial institutions from 24 member countries, including the United States. It also includes international financial institutions (e.g., the World Bank) and international standard setting and regulatory bodies (e.g., the IAIS).

Guarantee Scheme–Related Publications & Key Points

Key Attributes of Effective Resolution Regimes for Financial Institutions (October 2011)

- States that all key regulators of a global SIFI should maintain Crisis Management Groups, which should include "the public authorities responsible for guarantee schemes of jurisdictions that are home or host to entities of the group that are material to its resolution."
- Recognizes that access to information is critical and that "jurisdictions should ensure that no legal, regulatory or policy impediments exist that hinder the appropriate exchange of information, including firm-specific information, between supervisory authorities, central banks, resolution authorities, finance ministries and the public authorities responsible for guarantee schemes."

INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS (IAIS)

The IAIS is the principal international organization of insurance supervisors, engaged in creating international standards of insurance supervision and implementing the standards in the member jurisdictions.

Membership

The IAIS represents insurance regulators and supervisors in nearly 140 countries and 190 jurisdictions, representing 97% of the world's insurance premiums. The United States is represented by FIO Director Michael McRaith, NAIC CEO Terri Vaughan, and various state insurance regulators. An additional 120 entities participate as observers.

Guarantee Scheme–Related Publications & Key Points

Through June 2012, the IAIS will be translating how the *Key Attributes of Effective Resolution Regimes for Financial Institutions* issued by the Financial Stability Board (see above) in October 2011 applies to global systemically important insurance institutions. After June, the IAIS will go through a similar exercise with respect to the remainder of the insurance industry.

IAIS Response to FSB Consultative Document on the Resolution of Systemically Important Institutions (September 5, 2011)

- Criticizes the FSB's bank-centric focus when it comes to consumer protection in resolution of insurance institutions.
- While policyholder protection schemes provide assurance to policyholders that their contractual obligations will be met when due, the presence of multiple protection schemes for an insurer operating in multiple jurisdictions contributes additional complexity to the resolution process. For insurance regulators the emphasis remains on protection of the policyholder, and IAIS requests that the FSB take due regard of this work.
- Recommends establishment of international principles for policyholder protection schemes.
- Repeated emphasis on the importance of policyholder priority in insurance resolution procedures.

ComFrame Concept Paper Invitation for Comments [on Priority A Elements] (July 2011)

- ComFrame is designed to develop methods of operating group-wide supervision of internationally active insurance groups (IAIGs), establish a comprehensive framework for supervisors to address group-wide activities and risks and set grounds for better supervisory cooperation, and foster global convergence of regulatory and supervisory approaches.
- ComFrame is to be in the development phase for three years (2010–2013).
- The Concept Paper serves as a platform to further crystallize the needs and methodologies regarding the supervision of IAIGs.
- ComFrame builds on several key "Modules" that are further elaborated on by corresponding "Elements." This structure has been designed to allow ComFrame to compartmentalize the various pieces of work and develop them separately, yet in a well-coordinated manner.
- Module 2, Element 7 lists requirements for approaches for policyholder protection schemes. Element 7 is a Priority C Element, for which invitation to comment is scheduled to be issued July 1, 2013.
- Currently, Element 7 consists of the following concepts: (A) IAIGs and insurance legal entities are aware of which policyholder protection schemes apply to insurance policies that they issue and how these apply to the respective policies; and (B) Insurance legal entities within the IAIGs disclose to policyholders the terms of policyholder protection schemes that apply to the insurance policies which they issue.
- In addition, IAIS will request answers to the following questions: (A) Should the standard include requirements for supervisors with respect to policyholder protection schemes and tied assets? (B) By whom should disclosures be made? (C) Under what timing and in what format should disclosures be made? ✭

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NOLHGA Calendar of Events

2012

July 24–25	**MPC Meeting** **Boston, Massachusetts**
July 26–27	**NOLHGA's 20th Legal Seminar** **Boston, Massachusetts**
August 11–14	NAIC Summer National Meeting Atlanta, Georgia
October 1	**MPC Meeting** **San Antonio, Texas**
October 2–3	**NOLHGA's 29th Annual Meeting** **San Antonio, Texas**
October 21–23	ACLI Annual Conference Washington, D.C.
November 29– December 2	NAIC Fall National Meeting Washington, D.C.

2013

January 8–10	**MPC Meeting** **Clearwater, Florida**
April 6–9	NAIC Spring National Meeting Houston, Texas
April 9–10	**MPC Meeting** **Salt Lake City, Utah**
July 9–10	**MPC Meeting** **Chicago, Illinois**
July 11–12	**NOLHGA's 21st Legal Seminar** **Chicago, Illinois**
August 24–27	NAIC Summer National Meeting Indianapolis, Indiana
October 27–29	ACLI Annual Conference St. Louis, Missouri
December 15–18	NAIC Fall National Meeting Washington, D.C.

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