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Hot Time in the City

Attendees of NOLHGA's 2016 Legal Seminar enjoy summer in our Nation's Capital

By Sean M. McKenna

In the list of things that go well together, you have to scroll down pretty far—past Abbot and Costello, Martin and Lewis, and even cabbage rolls and coffee—till you get to "Washington and July." And yet just a few months ago, more than 200 people braved the heat and humidity to attend NOLHGA's 2016 Legal Seminar at the historic Mayflower Hotel, gathering insights into the future of domestic and international regulation, the continuing impacts of the Dodd-Frank and Affordable Care Acts, the importance of cybersecurity, and the vital role played by the guaranty system.

Humidity wasn't the only thing in the air. The Legal Seminar visited Washington for the first time in its history because organizers knew that 2016 would be a red-hot presidential election year. In fact, the Republican National Convention took place the same week as the seminar, and many presenters talked about the upcoming election's implications for the federal and international legal and public policy landscapes. And while it may be true that the D.C. heat was enough to ensure that the seat of government often found itself stuck to the chair when trying to stand up, it's also true that the 2016 Seminar was one of the best seminars in recent memory.

Brexit & Bedrock

Two presentations delved into the challenges facing insurance regulators and the companies they oversee. In *The Changing Shape of Domestic Regulatory Modernization and Progress in 2016 and Beyond*, always-charming moderator Charles Richardson (Faegre Baker Daniels) led attendees and panelists on a whirlwind tour of the financial services landscape. Highlights included:

Regulatory & Industry Challenges: Christine Neighbors (Nebraska Department of Insurance) didn't hesitate when asked about the challenges facing the states. "The Affordable Care Act is the biggest challenge we have," she said. "Most commissioners still spend more time than you think on the ACA. The time and energy spent on that in my office is unreal."

Leigh Ann Pusey (American Insurance Association) named the economy as her chief concern. "It's not moving at a pace to give the certainty and predictability that markets need," she explained. She also pointed to the Dodd-Frank Act: "It's been six years, and it's not remotely

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The Challenges of Long-Term-Care Insurance

Man plans, and God laughs. So says a Yiddish proverb suggesting that God is a forensic actuary experienced in long-tailed insurance claims.

Beginning roughly 40 years ago, several insurance companies began offering their customers a new type of insurance contract aimed at mitigating consumer risk for the unpredictable costs of health care for extended periods, especially in their retirement years. Thus was long-term-care insurance (LTCI) born.

Over time, many insurance companies—eventually more than 100—entered the LTCI market. Some of those were companies commonly perceived as life insurance or annuity writers; some were commonly perceived as medical insurance writers. Over the years, the bulk of the LTCI business appears to have been written by life and annuity companies.

About four decades later, almost all the medical insurers have ceased to write new LTCI business, and only a handful of life and annuity insurers are writing new business—at least in the form in which LTCI was offered in the first stage of the product's development. Today, there are no more than about a dozen companies—perhaps fewer—actively involved in the marketing and sales of that product.

Today, there are no more than about a dozen companies—perhaps fewer—actively involved in the marketing and sales of LTCI.

So what happened to cause a market that expanded so quickly to contract as quickly as it has done? Man planned, and God laughed.

LTCI is a long-tailed insurance product. That means that the contract is entered into in year X, but claims may not be presented (if indeed they are ever presented) until year X+20, or even year X+40. The financial viability of an insurer's block of any long-tailed business, including LTCI, can be materially affected by developments on many fronts between the date of initial contract formation and the time claims are presented.

Perfect Storm

In its earliest days, LTCI took on several attributes that, supported by developments in state and federal law, embedded in the original form of the product some features that were both appealing to consumers and risky to insurers.

For example, LTCI is a level-premium, yearly-renewable contract. That means that the original premiums are intended to remain level over the life of the contract and that, so long as the consumer keeps paying premiums, the contract remains in force and cannot be cancelled or modified unilaterally by the insurer. To be sure, the contracts generally provide that premiums can be adjusted for a class of policyholders, when premium increases are actuarially supportable (particularly as a result of unanticipated market and economic developments), with the approval of the regulator in the policy's state of issuance. As any LTCI carrier will tell you, regulatory approvals for these premium increases have sometimes been difficult to obtain.

In addition, state laws require LTCI contracts to be offered along with an optional (and separately priced) rider providing for an annual increase in maximum benefits as a hedge against medical inflation. For practical purposes, virtually all sellers of LTCI for decades have met that requirement by offering riders providing an annual 5% increase in maximum benefits, and many consumers have purchased such riders. Most of those riders were sold when investment markets offered returns much higher than the historically low returns available since the 2008 financial crisis. As a result, many of those riders have proven to be severely underpriced.

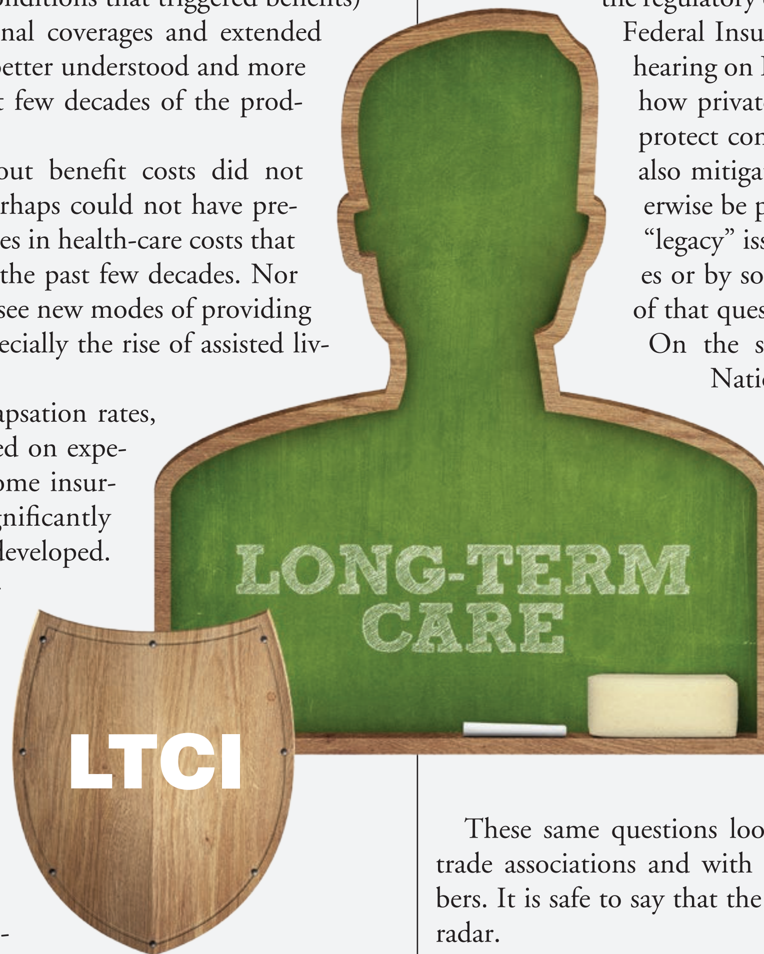
Assumptions are always used in setting premium rates for any insurance products. With established products, two important assumptions involve projections of contractual benefit costs and the rate of policy lapsation (when contract owners decide to terminate their contracts). Benefit costs and lapsation rates can be projected with reasonable accuracy if insurers have solid historical data for the same or very similar contracts.

LTCI, as a novel product, had no directly pertinent historical data upon which to base assumptions regarding benefit costs. Additionally, as a new product, the basic structure of the LTCI contract and the benefits it provides was the subject

of considerable trial and error until contract terms (particularly the specification of conditions that triggered benefits) and the pricing for optional coverages and extended coverage periods became better understood and more standardized after the first few decades of the product's existence.

Initial assumptions about benefit costs did not accurately predict (and perhaps could not have predicted) the massive increases in health-care costs that have been witnessed over the past few decades. Nor did product designers foresee new modes of providing long-term health care, especially the rise of assisted living facilities.

Even assumptions on lapsation rates, which were originally based on experience from disability income insurance, proved to be significantly higher than what actually developed. Consumers who purchased LTCI held—and continue to hold—onto it more tightly than most insurers originally predicted.



The bottom line is that benefit costs have developed much faster than product-funding support (premiums, premium increases, and investment earnings in a near-zero-return market). As a consequence, LTCI books of business—especially contracts written in the early years of LTCI (sometimes referred to as "legacy business")—have become major financial challenges for companies that wrote that business. These challenges are even greater for companies that focused solely on LTCI, as opposed to companies at which LTCI was only one element of a diversified suite of product offerings.

Said differently, without increased funding support for LTCI products, in the form of premiums more closely matched to the value and costs of the benefits these products deliver to consumers, many insurers have withdrawn from the traditional LTCI market, and those with large "closed" blocks of LTCI (i.e., companies no longer actively marketing the product but with older contracts still in force) are financially challenged.

This situation has several implications: (i) Consumer needs for funding long-term health care are not being met by the private sector, and individuals' financial plans and the costs of government programs are soaring as a result; and (ii) liquidations of LTCI writers are distinctly possible. Viable paths for incenting new product offerings, avoiding liquidations (if possible), and effectively handling the resolution of insurers with legacy LTCI business must be developed.

These implications have not gone unnoticed in the regulatory community. In August 2016, the Federal Insurance Office (FIO) conducted a hearing on LTCI. The primary focus was on how private LTCI can, in the future, help protect consumer needs and finances while also mitigating social costs that might otherwise be passed on to taxpayers. Resolving "legacy" issues—through premium increases or by some other means—is a large part of that question.

On the state level, the NAIC Summer National Meeting, held in San Diego this August, featured so many discussions about LTCI resolution and the future of LTCI that a senior regulator observed afterward that the only meeting where these issues were not discussed was a session on insurance coverage for "driverless" cars—and then only because participants in that meeting ran out of time.

These same questions loom large at the major insurance trade associations and with their insurance company members. It is safe to say that the future of LTCI is on everyone's radar.

Guaranty System Response

That is especially true of the guaranty system. A case well known to *Journal* readers—one that has lingered seven-plus years—is expected to move to liquidation soon. It will not be the largest insolvency the life and health guaranty system has faced, but it is likely to be one of the most expensive, in significant measure because of the factors mentioned above.

The pending case illustrates several key issues important in both the case itself and the broader discussion. Chief among them, from our perspective, are the obligations facing the guaranty system. Our member guaranty associations—their Boards and member companies—are responsible for standing behind contractual obligations of a failed writer of LTCI, within the scope of guaranty association coverage mandates. In this case, the associations will soon be called upon to provide billions of dollars' worth of coverage, and this coverage will stretch out for decades.

While the scope of the problem may be large, the challenge—protecting policyholders—is familiar. And here, as always, the guaranty system will perform its role efficiently and effectively, providing protection to tens of thousands of people in need.

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NOLHGA Conversations

"The Job of Government Is To Come Up with Regulations That Meet the New Reality"

Barney Frank discusses his proposal for Free Enterprise Day, the value of the FSOC, and the vagaries of American politics

Barney Frank served as a U.S. Congressman from 1981–2013 and as Chairman of the House Financial Services Committee from 2007–2011. As Chairman, Rep. Frank was instrumental in crafting the short-term $700 billion rescue plan in response to the mortgage crisis, and he then worked for the adoption of a sweeping set of financial regulations aimed at preventing a recurrence. He was co-author of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the regulatory overhaul signed into law in July 2010. He also led passage of the Credit Cardholders' Bill of Rights Act, a measure that drew praise from editorial boards and consumer advocates.

The following is an edited transcript of our conversation at NOLHGA's 2016 Legal Seminar on July 22.—Peter G. Gallanis.

Gallanis: *Chairman Frank, before we begin discussing the Dodd-Frank Act itself, could you give us an insight or two on the congressional perspective as the 2008 financial crisis was unfolding? For example, were there specific moments or developments that particularly persuaded you or many of your colleagues that this was more than just another recession?*

Frank: Yes, very dramatically and emphatically in September. But I would say this: Most of my colleagues were not aware that a crisis was coming. Very few people were.

In 2006, it became probable that the Democrats were going to take over the House. And my efforts in this began with a phone call from Hank Paulson, George W. Bush's Treasury Secretary. He said, "I think you're going to be the Chairman. We have been unable to do anything about Fannie Mae and Freddie Mac." The Bush administration had been inclined not to do anything about it, because the one time they tried to pass legislation—with the Republicans in power in the House and Senate, and George Bush as president—a bill passed the House, but the Senate Republicans didn't like it. It badly split the Republican Party.

Mike Oxley, of Sarbanes-Oxley fame, when asked why they hadn't been able to pass the bill, said, "Well, George Bush gave me the one finger salute." And as Paulson recounts in his book, there was a sense that this was going to fracture the Republican Party. And as Paulson again says in his book, he went to Bush. Paulson was in an unusual position. His role in this was quite central, because he finally led George Bush into a lot of things in 2008 that ran counter to what most Republicans wanted to do, and which have now been repudiated by all the Republicans.

It was an interesting thing. If you hire someone for an important job, ordinarily that person is somewhat obligated to you. But if you beg someone to take a tough job that he doesn't want, the obligation is reversed. And that was Paulson. He had turned it down a couple of times, and he said he was told by Karl Rove, "He can't turn you down after you agreed to this."

So Paulson got permission to take up Fannie and Freddie. In the early part of 2007, and this is contrary to some of the popular history, the first bill we worked on when I became Chairman was to reform Fannie and Freddie, largely the way Paulson wanted, and we developed this working relationship.

As the year went on, he began to express some nervousness about things. We first became aware that things were going to be a problem, and we would have to deal with them, when Bear Stearns failed. And he made the marriage—he and Ben Bernanke—between Bear Stearns and J.P. Morgan Chase. And at that point, an interesting thing happened.

The Republicans who dominate the House Financial Services Committee tend to be very conservative. I was just talking to someone here about how they, on ideological grounds, strongly oppose Terrorism Risk Insurance, saying it should be left to the market, despite everybody we talked to in the market saying no, we can't do this and we don't want to do it.

The Republicans on that committee wanted me to have a hearing at which they could attack Paulson for his breach of free enterprise. Bear Stearns is going to fail? Let them fail—don't make this marriage. So I developed an alliance with Paulson. And as the year went on, I began to get more and more nervous because a pattern developed. Maybe every other Friday afternoon, after 4:00—the closing of the markets—I would get a call from Paulson with this story of another disaster. I'd say, "You ruined my weekend; I don't know whether I want to talk to you." So as 2008 went on, we became more and more aware of that.

He and Bernanke—I worked very closely with both of them: two Bush appointees. And it's interesting for people who follow this; if you look at American history, there have been, until fairly recently, tensions between the Secretary of the Treasury and the Chairman of the Fed. One thing that goes to the great credit of the Bush administration—and the Obama administration has perpetuated this—is that you had a total unity and cooperative effort between those two, which was very helpful in minimizing the damage.

So they said here's our problem: If a large institution is about to go out of business, we have only two choices—either we step in and pay all of its debts, or we let it go out of business with all the danger that would cause. We had begun to understand this, and in July and August I started planning to deal with it legislatively. And then we come back from the recess. I was

aware of the problems, but it was not generally known for a couple of a reasons. First of all, this was sort of obscure stuff—a lot of members weren't following it, and it wasn't having any negative impact in general.

But secondly, the last thing you want to do is say, hey, things are really tough. Because you make it worse. You're in this dilemma. You don't want to hide things from people, but there's a reason Paulson was calling after the markets closed. I didn't want to get up and say, "Hey guys, we're in a terrible crisis," which would have exacerbated it because it was a crisis of confidence as much as anything else.

I kept hearing from him that the rescue of Fannie and Freddie didn't work; we were going to have to take them over. And I get a call in September saying, "I'm about to go take over Fannie and Freddie. They're going to go to the Hill to protect them. Will you support me?" I said of course, and that went forward.

So we kept seeing it building. Then in September, we're summoned to a meeting. This was after Lehman failed. There had been people saying "Let Lehman fail." Bernanke talks about this in his book; both Bernanke's and Paulson's books are excellent on this. Lehman fails, and none of its debts are paid. And the world begins to freeze up.

And at that point people say "Oh, this is the worst thing since the Great Depression." It had the potential to be worse than the Great Depression, because when the Great Depression hit in 1929, there was geographic particularity in the world. But by 2008, we were in one grid. German banks failed because of American mortgages, none of which had been issued in Germany.

So when Lehman failed, it froze up. And there had been people who said "Good, let it fail, because that'll show free enterprise." And that includes many of the Republicans who now control the Financial Services Committee. Of course the impact was so negative that two days later, when AIG came in and said we can't pay our debts, they said we have to step in. I guess there's a new paper out saying that they could've saved Lehman. I think they wanted to, but they felt they didn't have the legal authority.

But after Lehman failed, almost all those who were saying "Let them go bankrupt; that's free enterprise" changed their mind. As Bernanke notes, I said I was going to file a bill to declare September 15th Free Enterprise Day because we had unrestricted free enterprise for one day: the day that Lehman failed. By the next day, people said, well, not so much.

We saw it building, but only a few of us. We were being told it was bad, and then we could see it was worse than we thought.

THE PROBLEM IS NOT THE SIZE OF THE INSTITUTION—IT'S THE SIZE OF ITS INDEBTEDNESS. SO TO THE EXTENT THAT YOU'VE REDUCED THE CAPACITY FOR INDEBTEDNESS, YOU MAKE THE SYSTEM SAFER.

By September, here's the deal. First, the psychology: The economics and politics shifted. Until Lehman and AIG, within a couple days of each other, you didn't want to scare everybody. But after AIG failed, you had to scare everybody. The members of Congress were required to take some steps that we knew were going to be unpopular. I believe TARP could've been better, but I think on the whole it succeeded, and at much less cost than anyone thought.

I think TARP will go down in history as the single most successful, unpopular thing the federal government ever did. And I would tell you that all the anger that is so obvious in today's electorate came to a white heat in March 2009 when AIG announced that it was paying bonuses to the people who had been involved. I've never seen such anger, and even though people may not remember why they're angry, I think that is the point at which you start to go the other way.

The only other point I would make, and we'll get into this, but this is the Republican administration under George W. Bush coming to a Democratic Congress—coming to Nancy Pelosi and Harry Reid. And they then told Chris Dodd and me to go to work. Actually, for most of 2008 I worked very closely with Paulson, and then with Bernanke as well. And in

2008, in September and October, the Democratic Congress and the candidate, Barrack Obama, worked very closely with the Bush administration over the objection of a majority of House Republicans and the ambivalence of John McCain.

Gallanis: *There was the famous moment when Secretary Paulson went down on his knees in front of Speaker Pelosi, and really the motivation—not for the theatrics, but for the strength of his request—was that he couldn't have gotten what he needed just from the Republicans in Congress.*

Frank: That's an understatement. What he was saying to Nancy Pelosi was, "Please do not let your understandable anger at the Republicans attacking all of this dissuade you from doing the right thing." And it didn't. We had a deal worked out. There were four parties, and the Senate Republicans, the Senate Democrats, and the House Democrats were all for it.

The House Republicans were against it on the whole; they were ambivalent. Eric Cantor had an alternative, and John McCain, people will remember, interrupted his campaign—said we wouldn't have a debate, and he came to Washington to resolve it. He called to my mind Mighty Mouse—"Here I come to save the day." At his request, George Bush convened a meeting in the White House of the Congressional leadership, Barrack Obama, and John McCain. At which point all the Democrats present said, "Mr. President, we support what you do."

John McCain wouldn't take a position, and the House Republicans said they were against it. When the bill went to the floor of the House the first time, they got a majority of Democrats, but a heavy majority of Republicans voted against it. Enough for it to be defeated.

What happened then was—and here's a story about American politics: not beneficial, but illustrative. Before the vote, members' offices were flooded with people saying vote against it. Then it comes up and it fails, and the market has its biggest single drop—maybe ever, but at least in a very long time.

And at that point, the phone calls and letters, the e-mails, switched to vote for it. It's partly because people saw the negative consequences, but it's also a factor of our politics. The people who are afraid that the outcome will be unfavorable are the ones you hear from. The people who like what they think you're going to do don't bother to tell you that.

So when the bill was pending, and people assumed it was going to pass, we heard from the no's. When it failed, then we heard from the yes people who realized that they had to do this. But even on the second vote, a majority of Republicans voted against it: a smaller majority. But the House Republicans and John McCain remained consistently opposed to it.

I've had people say to me, "You were so supportive. Does that mean you just thought it was wonderful?" Here's an important lesson about legislative-executive relations—over time the Congress is very powerful, but in a moment of crisis, inevitably the executive is in charge.

As a member of Congress, you have two choices—particularly if you're Chairman of the committee. You can say no because it isn't to your liking completely. You can say no and let things get worse, or you can vote yes. Though we did get some concessions out of Paulsen.

Here's the problem too, and it gets worse with the Internet: The incentive system of our politics leads to Congressional negativism. Some of you probably look at the Internet more than I do. But I have never met anybody who ever saw on YouTube or anything else a video of a Senator being nice to a member of the Cabinet. Nothing ever went viral where someone said "You did a really good job. That was very creative. You really handled that." Everything you see in that regard is somebody yelling, and waving a fist, and being abusive.

The way it works for a member of Congress is, if the administration does something you approve of and you vote yes, the administration gets all the credit. If the administration does

something controversial and you say no, then you get to be the leader of the opposition. And I give us credit, frankly, because Pelosi and Reid and myself and Chris Dodd overcame that and said, "This is really serious business. The country's in serious trouble." And we were supportive.

Gallanis: *There's another wrinkle on that, and I've heard you say this before: Not many monuments are built to recognize how political actions kept bad things from happening or from getting worse.*

Frank: That's sort of what your business is. You're in the business of incentivizing people to do things that minimize disaster. In politics, you get no credit for disaster averted.

I mean, Chris Dodd, who was a wonderful Senator, ran into serious trouble. He'd filed an amendment to the TARP bill that said that the people getting TARP funds shouldn't be able to give bonuses to a certain class of people. He made it retroactive, and he ran into the fact that retroactivity was unconstitutional.

So he said, "I can't make it retroactive, but at least we can prevent them going forward." And when AIG issued its bonuses, people were so angry they blamed Dodd because he hadn't made it retroactive, which he'd wanted to do. He was the only one who did anything.

I had my toughest race in 2010. It validated a point I made, by the way, about the nature of our democracy. You should not aspire to a position of leadership in either the federal Congress or a state legislature unless your district is such that you can lose 15% points and still get reelected. Because the role of the leadership is to take the heat for unpopular actions and let the members shelter behind you. You make a deal—they give you more authority, and they will in the end vote for the right thing, but you have to structure it in a way so that they don't get the full blame for it.

I had members come to me—not a lot—when I was Chairman, and say about such and such a bill, "It's very popular. Are you going to bring that up?" I said no, you know it's irresponsible. They said, "I know. So it's definitely not going to come up? Okay, then I can tell people I'm for it." So they do that without any fear that they would have to vote for it. And that validated itself in my case. In 2008, I got 68% of the vote; even that was down a few points from my norm. In 2010 I got 54%, and I won by 11 points. There was such anger.

So at one point I said I wanted to make up a bumper sticker, and somebody actually made one up for me. It's kind of a joke. I did not use it, but it was kind of the theme of my campaign: "Things would have sucked worse without me." That's often the justification, but it's not something you can really argue for.

To an economist, a change in the rate of change is an important thing. If things are getting worse and you dramatically slow down the rate of deterioration, that's a sign that you've done something right. But you cannot run for office on that.

THE PRIVATE ECONOMY IS DYNAMIC; REGULATION GETS OUTSTRIPPED AS ECONOMIC REALITY CHANGES.

Gallanis: *Turning to the development of the Dodd-Frank Act, were there factors that you and your colleagues saw that contributed to the 2008 crisis that became your policy targets in the drafting process? Were there activities or factors or risks that needed a regulatory approach different than what had existed?*

Frank: Two in particular, both of which we addressed. The single most important was the granting of residential mortgages to people who were unlikely to be able to pay them back. And that was a systemic change. People had said that deregulation led to the crisis. It wasn't deregulation—it was non-regulation.

The private economy is dynamic; regulation gets outstripped as economic reality changes, and the job of government is to come up with regulations that meet the new reality. They did that with antitrust in the 1890s and the turn of the century. In 1850 there was no large economic entity in America. By 1890 there was, so we came up with antitrust laws and the Federal Reserve. Then you had the stock market becoming important, so the New Deal is a lot of regulation of the stock market, creating the SEC and the Investment Company Act.

That works pretty well, and in the 1970s, two things changed. In 1960, almost all of the loans that were made—individuals to corporations, etc.—were made by banks, which were highly regulated because they had deposit insurance. And the lenders bore the

risk if there was not repayment. They held the loans. And obviously, there was no mechanism by and large for not doing that.

Two things happened in the 1970s. First of all, we saw increased liquidity from outside the banking system—from OPEC, from China and Japan with large trade balances, from sovereign wealth funds. A lot of money now starts coming in from outside the banking system.

Secondly, even within the banking system, securitization comes in. And so by 2000, the great bulk of loans were being made by people who did not hold them in their portfolio—who sold them. And what happens, particularly in residential mortgage loans, is that the incentive for the lender has now shifted. Instead of worrying about the quality of each loan, you're interested in the quantity of the loans you make because you get rid of them.

And by the way, that could not have happened without the development of information technology. You couldn't hand count all those loans and securitize them. And the system hadn't caught up with it. So first of all, we wanted to deal with the bad loans. We had to find a regulatory replacement for the market discipline.

By the way, my view was—and I got a little bit defeated in the end on this in the adoption of the regulation, but it's still possible—that the best way to replace the market discipline was by requiring that the securitizer take a certain percentage of the loans off the top. Risk retention. That's there for nonresidential, and it could be there for residential. I differed with the regulators about that.

By the way, Glass–Steagall had nothing to do with that. Under Glass–Steagall, you could have made bad loans. In fact, they started making these bad loans in the 1980s and 1990s, when Glass–Steagall was still in effect.

The other thing was financial derivatives. Derivatives had been used for real physical commodities: think of the Commodity Futures Trading Commission. And now you have financial derivatives. My analogy is the bad loans were the bullets and financial derivatives were the guns that slung them all around. And there was zero regulation of financial derivatives in Congress, and the president specifically decided not to do that. Brooksley Born wanted to do it and was told no.

So those were the two major things we wanted to do: regulate mortgage lending and derivatives. Here was the problem with derivatives; AIG showed it. AIG shows up at the Fed in September and says "We're $85 billion short of being able to pay the credit default swaps that we owe." Bernanke said he had no option after Lehman failed. So he said okay, I'll do it.

A week later, Bernanke and Paulson are counting up how much money they're going to need from TARP, and they said $85 billion for AIG. We said, "Wait, I thought you gave them $85 billion of the Fed money." And Bernanke said "No, this is another $85 billion." Not only did AIG not have enough money to cover their debts; they had no idea how indebted they were. This is not controversial. They acknowledged this.

It turns out they were $170 billion short of being able to pay off on their credit default swaps, rather than $85 billion. So the other thing we said was, there has to be backing—there has to be margin, there has to be capital. We want to put them on exchanges where we can.

Those were two things that we thought would make it less likely you'd have a crisis. The third major piece is this. Bernanke and Paulson had come to us after Bear Stearns and said here's our problem: If a big institution fails, it will have an impact. And by the way, the problem is not the size of the institution—it's the size of its indebtedness. So to the extent that you've reduced the capacity for indebtedness, you make the system safer.

A very large institution that can pay its debts is not that kind of threat. But they said, "Here's our problem. If an institution like that goes under, we can either pay none of its debts or all of its debts." So they asked us for a third way, which is largely in the bill and was largely their suggestion: a way for the federal government to step in if an institution like that shows up, dissolve it,

put it under receivership, pay, liquidate whatever they can, and pay as much of the debt as that allows.

Then as to the remaining debt, not pay all of it, but pay only as much of it as is necessary to prevent the knock-on effects from being too destabilizing. And then recover anything paid out from other large financial institutions. Those are the three main pillars of the bill.

Gallanis: *One of the other things the Dodd-Frank Act does is create some restructuring of the regulatory framework aimed at risks to the financial system. And in particular, it establishes in Title I the Financial Stability Oversight Council, or FSOC, which I think many know is a body that's chaired by the Secretary of the Treasury and has nine other voting members: Comptroller of the Currency; the Chairs of the Federal Reserve, SEC, FDIC, CFTC, and CUA; and the directors of CFPB and HUD. Then there's also an independent member with insurance expertise appointed by the president.*

Looking at the constitution of that body, can you tell us generally what you and the other leading drafters of the legislation envisioned the Financial Stability Oversight Council doing as an entity that its individual constituent members weren't doing before its formation?

Frank: First of all, talk to each other on a regular basis, which was very important because with the new things that happened, they had overlapped the existing channels significantly. You did not have things as neatly defined as before. Secondly, to have the power to act.

You asked what we were trying to resolve. We knew there was a problem with bad mortgages. We knew there was a problem with derivatives. We also knew that going forward, given the dynamism and capacity to innovate in the economy, something new could come up that we couldn't foresee.

And so one of the things we did was to give the FSOC the power to look at new stuff, and we didn't know which agency it would affect. So as a collective it can be forward looking, and they had the research arm to help look. Then it also has the power to step in; I think it's a two-thirds vote—by a two-thirds vote, they can order one of the agencies to take another look at something.

That happened with money market funds and the SEC. They ordered the SEC to go back again. We all know there is a story of regulatory capture. You work with people; there is a possibility that an agency in the industry that it regulates might not have the objectivity it needs. So the FSOC as a whole can order them to do things. And finally, you make sure that there is a macro as opposed to a micro look at the way things work.

One question that's sort of implicit in all this is, why not consolidate regulators? In a rational world, you would not have a separate Securities Exchange Commission or Commodity Futures Trading Commission. But in America, with the Commodity Futures Trading Commission having been the representative of the agricultural interests and the SEC representing the financial interests, there was just no way you could merge them.

Tim Geithner said, "Can we merge those?" I said, "In theory, yeah. In America, no." Because they're just deeply rooted. Inevitably, it would've been seen as putting the CFTC into the SEC, given the size disparity.

Then there's the question, why do you have bank regulators who obviously control the currency and the Federal Reserve? And there's one factor about American banking that's unique to us, and other people don't realize this. We have what we call a dual banking system; we have federally chartered banks and state-chartered banks. The state-chartered banks are the smaller banks. And there was a proposal to essentially take the Federal Reserve's Bank Regulatory Authority away and put it all in the Office of the Comptroller of the Currency. People are critical of the Fed; they get blamed over the AIG thing—I think somewhat unfairly.

And the head of the Independent Community Bankers came to me and said "You can't do that. We'll go crazy."

WE ALSO KNEW THAT GOING FORWARD, GIVEN THE DYNAMISM AND CAPACITY TO INNOVATE IN THE ECONOMY, SOMETHING NEW COULD COME UP THAT WE COULDN'T FORESEE.

Because the state-chartered banks are regulated by the Federal Reserve, and the federally chartered banks are regulated by the Comptroller of the Currency. He said, "We do not want to go to the same regulator as the big banks; we are afraid of one-size-fits-all regulation."

By the way, there's this mistaken view about all the political power that big banks have. The big banks have got squat in political power; nobody likes them, and they're concentrated in a few areas. The power is with the credit unions and community banks. In your business it's with the independent insurance agents. It's with the Realtors. The power in America is in national grassroots networks: businesses that have tens of hundreds of people in everybody's Congressional district, with an economic interest. And they are very, very tough.

Gallanis: *There's an important power afforded to the FSOC under Dodd-Frank as I understand it, which is the power to step in and work toward and effect changes related to activities that could threaten the financial system. Is the FSOC doing everything that you and the other drafters of the legislation had hoped it would be doing by way of activity supervision?*
Frank: Yes. I mentioned the money market funds and the SEC, and the SEC regulator stepped up. It's implicit in what I said before—we don't know where the threats are going to come from, and one of the reasons you have the FSOC is that the next threat may well overlap any of these investigations.

One of the things they're looking at, to the discomfort of some, is hedge funds. Who's in charge of hedge funds? Frankly, there was no regulatory authority over hedge funds to some extent. They were selling it as a security. So yes, I believe they are doing that very well. As I said, in the one case they used their power to tell the SEC to, in effect, tighten up on money market funds. And with that one, the Chair of the SEC wanted to do something, but she couldn't get the three votes she needed. So basically she was very happy to be ordered by the FSOC to do what she wanted to do in the first place. The SEC is a voting member of the FSOC, so she could vote to order herself to do this.

I think you see this with hedge funds; they will, for example, probably stop and get peer-to-peer lending, which is another example of something that could become a big issue that's outside any individual entity's regulatory authority.

Gallanis: *In your view, is traditional insurance business likely to be a source of systemic risk?*
Frank: No, that's why we don't do anything about insurance in the bill. All we do in the bill about the traditional insurance business is to appoint somebody who will know something about insurance, probably so we don't do anything sort of accidentally that hurts the business. Look at that bill; there's nothing in there that regulates insurance.

What happened was an insurance company was doing so well in the insurance business that—and this seems to be literally the case—AIG had more money than they knew what do with. So they went and did things they didn't know enough about. But the traditional insurance business remains entirely a state business.

When I was in Congress, there were efforts to increase the national role in insurance regulation. They have been most successfully and effectively resisted, by the way, by the agents. We did believe it was important to have some people in the federal financial structure who knew about insurance.

And when you're dealing with AIG, your problem is they're non-insurance agents. You want to make sure you have somebody who knows something about the insurance business so that you don't inadvertently injure that business. So no, we did not think the traditional business of insurance is a threat. We all wished AIG had stuck to insurance and hadn't gotten into financial razzle-dazzle.

Gallanis: *You've been an outspoken supporter of Secretary Clinton, and in the polls she's led pretty consistently, though with some ups and downs. How do you foresee the 2016 elections playing out for the presidency and for potential changes of control in the Senate and the House?*
Frank: I think Hillary Clinton will win. I would say two things about her. First, yes, the e-mail thing was obviously a dumb thing to do. Beyond that, I spent most of the 1990s dealing with Republicans who were trying to prove that she'd done something wrong. Kenneth Starr, in the impeachment hearings in 1998, said that with regard to Whitewater, Vince Foster, the FBI files, and the travel office—all the accusations involving her—there was zero negative evidence.

I asked him at what point he had exonerated the Clintons with regard to one of those, I think it was the travel office. And he said he couldn't tell me when he exonerated them because there'd never been anything that implicated them. So I think she's a victim, and I've asked people, what is it you think she did wrong? And as I said, they tried very hard to prove things, but they couldn't.

But the e-mail thing could be a problem. I think the other problem she has is this, and I think it's a testimony to her

["Rep. Barney Frank" continues on page 26]

"One of the Privileges of Being an American Is That We Get To Sue Our Government When It Misbehaves"

Eugene Scalia discusses the challenges in taking the federal government to court and why suing federal agencies isn't the insurmountable hurdle some make it out to be

Eugene Scalia, a partner with Gibson, Dunn & Crutcher LLP, has extensive experience participating in matters before federal regulatory agencies and challenging agencies' actions in court. His experience challenging federal regulations has been widely reported in the legal and popular press, including in a BloombergBusinessweek *article titled "Suing the Government? Call Scalia" and a* Wall Street Journal *article titled "Another Scalia Vexes Regulators." He currently is counsel for MetLife, Inc., in litigation challenging its designation as a systemically important financial institution.*

The following is an edited transcript of our conversation at NOLHGA's 2016 Legal Seminar on July 21.—Peter G. Gallanis.

Gallanis: *Since the early days of federal agency growth and development, from the Progressive Era and through the New Deal, people have said that there exists a significant tension between what we might call the democratic ideal—popular sovereignty—on the one hand, and on the other, the existence of robust administrative powers—regulations that are promulgated by and enforced by unelected civil servants. Is that perceived tension a real concern?*

Scalia: I think there is definitely a trade-off involved. When the most important legal obligations in society are determined by Congress with the assent of the President, you have people who are elected either directly or indirectly by the American people making the rules of government. The more that Congress concludes, "Gee, this is complicated, detailed stuff—what we'll do is lay down the broad outlines, and we're going to give this over to folks at the agencies to fill in all the content and details," the less there is the sort of accountability on the part of popularly elected officials that the Framers envisioned.

That's obviously not to condemn the entire administrative state, which I have served in three times myself. It's just to say that, yes, there is some tension and a trade-off between having people who are directly accountable to the voters making the law, versus having folks—like I once was—who are not themselves politically accountable playing a very, very fundamental role.

Gallanis: *As the New Deal progressed, Congress—which at the time was not unanimously supporting FDR on everything—began a long process of developing rules to constrain the operations of federal agencies. After a decade or so, that process led to the adoption by Congress of the Administrative Procedure Act in 1946. Can you give us a sense of the significance of the Administrative Procedure Act as it is used today and what the role of the APA is in clarifying the boundaries of agency authority?*

Scalia: I think of the APA as the law that governs the government. There are a lot of laws setting down the rules of the road for private individuals, institutions, etc. The APA lays down some rules of the road for the government, and obviously in the process sets forth certain rights for people who are affected by government action. An example is the notice and comment process. Either the APA or similar principles laid down in what we call an agency's own "organic statute" provide an opportunity for the public to participate in the development of rules that are issued by agencies— to comment, so that you have a final rule that is at least the logical outgrowth of what was initially proposed.

I'm one of the few people who can get sentimental about the notice and comment process, for reasons that relate back to the point I was making earlier, which is that the administrative state certainly can be a threat to the democratic foundations of the country. And the notice and comment process is a way of reintroducing at least some element of democratic participation, by giving people notice of new regulations; giving them a right to provide their views; and, as a practical matter, forcing the agencies to engage with those views—to either accept them or reject them for sound reasons, which they explain. It also forces agencies ultimately to answer in court for their final decisions on those rules. That is, another important element of the APA, obviously, is its provision for judicial review of a broad range of what we call final agency actions, including the adoption of rule, a variety of orders that might be issued in agency adjudications, and the like.

The APA standard of review, which also exists under a lot of state laws, is called the arbitrary and capricious standard of review, which is a deferential standard of review. But it nonetheless holds regulators' feet to the fire by requiring them to do certain things and explain their decisions in a cogent way.

I like to tell this story: I was preparing a suit against the government a few years ago, and I was talking about it at dinner. One of my sons, who I think was about 11 at the time, just got this increasingly worried look on his face. And

he said, "Daddy, is it OK to sue the government?" And I said, "You know, Jack, this is a great country we live in. One of the privileges of being an American is that we get to sue our government when it misbehaves. And that's what I'm doing now. Let's wave a flag."

Gallanis: *There certainly have been some very high-profile challenges to administrative agency creation or funding, or rules that have been promulgated by agencies over the course of the last few years. One thinks back to some of the litigation related to the Affordable Care Act, and to the MetLife case that you've been involved in. And a lot of what one reads in the press is commentary to the effect that the arbitrary and capricious standard is such a high hurdle that it just can't ever be surmounted. What would you say about that?*

Scalia: It is a deferential standard. I suppose if I, as somebody who brings litigation against the government, could write my own standard that I could litigate under, it would be more demanding of the government. There are tighter, stricter standards one could write. But I'm always amused to read press accounts after I file one of these lawsuits against the government in which respected partners at major law firms hold forth about how I'm going to lose my case that I just filed because the standard is arbitrary and capricious and you can never satisfy that standard.

I'm initially awed by these peoples' ability to hold forth in major national publications about cases they know nothing about—cases that I've been laboring over for months trying to find just the right legal arguments; going through the administrative records very carefully. And lo and behold, some guy sitting in a big building in New York gets a phone call from a reporter and he knows the answer to my case, far faster than I ever did.

But some of the things that get examined under the name of arbitrary and capricious review, some of the things that agencies need to do, are crucial. They need to consider important evidence in the record. They have to draw a rational connection between the facts in the record and their ultimate conclusions. There has to be, as the Supreme Court has said, a discernible path from evidence to conclusion. They need to explain what they've done, again in an intelligible way. They can't totally ignore important comments or important problems that were presented. And they can't, among other things, depart from their own prior positions and statements without at least acknowledging that they've done so and explaining why they're doing it. That last point, for example, is one of the arguments in play in the MetLife case.

Gallanis: *You've outlined a whole panoply of ways in which there's a requirement for the federal agency to justify what it's done—to make the argument that its actions have not been arbitrary and capricious. It's not an unbreachable wall.*

Scalia: No. The short answer is that agency actions get invalidated by courts every week under the arbitrary and capricious standard.

Gallanis: *Let me ask about another question of deference to administrative agencies. We sometimes read that courts afford to administrative agencies what is referred to as "*Chevron *deference," and that such deference is yet another reason—along with the arbitrary and capricious standard—why it's difficult for people who disagree with an agency's actions to challenge that agency. What is the notion of* Chevron *deference? Where does it come from, and why does it matter?*

Scalia: *Chevron* deference is the deference that courts may give to an agency's interpretation of statutory language. And so the paradigmatic *Chevron*-type circumstance is where there are specific words or phrases in a statute, and an agency says in its rule-making, "Here's what we believe those words mean. We, the agency, have been given authority by Congress to issue substantive rules under this statute. And we're interpreting it in this way, and here's our final rule." That's sort of the classic *Chevron* case.

Chevron is a little different than APA review under the

I'M ONE OF THE FEW PEOPLE WHO CAN GET SENTIMENTAL ABOUT THE NOTICE AND COMMENT PROCESS.

arbitrary and capricious standard, which isn't necessarily about the meaning of specific words in a statute. It's more about your reasoning and the overall outcome. *Chevron* deference concerns the actual treatment of statutory words. And the Supreme Court has said there's a two-step process. First, the court asks whether the statutory language is clear: whether the meaning is plain. And in doing that, it considers the language itself and other canons of statutory construction. And the courts have said they also consider legislative history at "step one." If it's clear to the court what the language means, they don't really care what the agency says. There's no deference. The agency's views don't come into play.

If, on the other hand, the court uses all the ordinary tools of statutory construction and it's a toss-up—it's just not sure what the right answer is—then the language is ambiguous, and the theory is that there is a delegation to the agency by Congress for the agency to figure out the best way to interpret and implement that language. And the court will uphold it under *Chevron* step two as long as the agency's interpretation is reasonable. And one corollary to that, by the way, is that there's not just one reasonable interpretation. You've only gotten to step two of *Chevron* if the statutory language is ambiguous, and therefore there is more than one possible meaning.

So it's quite possible for an agency in year one to say the statutory language means the following. And then in year 15, under a new presidential administration, to say, "Oh, you know what? We actually think it's preferable now to interpret it in the following way." That's not really inconsistent so far as *Chevron* is concerned. It's using the discretion that *Chevron* says Congress gave to the agency to work these things out.

Gallanis: *On behalf of your clients, you have successfully challenged several agency actions, including the attempt by the SEC to require registration under the Securities Act of 1933 of fixed variable annuity products. In that case, you argued that the SEC did not properly weigh the costs of agency action against the purported benefits. What is the role of cost-benefit analysis in the review and challenge of administrative agency actions? And what is the source of the requirement of a cost-benefit analysis?*

Scalia: Cost-benefit analysis comes into play in a number of different ways. Most obviously, there are some statutes that require agencies to consider costs and benefits or, for example, effects on competition, effects on efficiency—terms of that nature. So often the agency's own statute requires some form of cost-benefit analysis. That's true in large measure of some of the principal securities laws. It's also true of the Commodity Exchange Act. There are some parts of the EPA to which a requirement like that applies. So that's one way there can be a cost-benefit obligation.

Another is that since the Carter Administration, I believe, there have been presidential executive orders that require the federal departments to engage in a cost-benefit analysis and actually submit it to the White House Office of Management and Budget in connection with their proposed and final rules. The executive orders lay out appropriate considerations, and when agencies are proposing and then finalizing rules, they march through those considerations and explain how they have assessed the rules' costs and benefits. And at least in certain administrations, some cost-justification is required. It's not just that you have to consider the costs. It's that you can't adopt a regulation that's going to impose more costs than the benefits it delivers.

And finally, here's how I look at a lot of it. Agencies, when they're doing things, ought to be thinking about the impact. And they ought to conclude that the impact is good, not bad. If it's bad, they shouldn't do it. You can call these consequences, pros and cons, costs and benefits. The costs may be financial—and by the way, when you're regulating financial markets and products, those are a lot of the costs. Or there can be other kinds of costs. Obviously for some rules there are costs in lives, for example, or medical costs.

And so my view has been that even when there's not an explicit statutory requirement, and even when the presidential executive order doesn't apply, it's still appropriate for agencies to consider the costs, the negative impacts—including the negative monetary impacts—of the actions they take.

Gallanis: *One of the most recent additions to the long list of federal administrative functions involves the set of powers that Congress granted to the Financial Stability Oversight Council, or FSOC, under Titles I and II and other Titles of the Dodd-Frank Act. One of FSOC's Title I powers is the authority to designate a company as a "Systemically Important Financial Institution," or SIFI. As a consequence of that designation, the company is subjected to certain types of heightened regulatory scrutiny and other consequences. How are SIFI designations made under Dodd-Frank?*

Scalia: I can give a formal, technical answer to that. I won't speculate about what actually goes on.

Obviously Dodd-Frank itself identified certain institutions as too big to fail, as they're called, but then gave FSOC the authority to identify additional entities. FSOC promulgated some rules that established the process it would follow, where it would look at some basic indicators of size and leverage and other aspects of the financial institution to decide whether to review entities for potential designation.

There are three stages in its review process. At a certain point, a company is notified: "Hey, we're considering you for designation as systemically important." And the ultimate question is whether material financial distress at that company—that's the statutory language—could threaten the financial stability of the United States. So they're supposed to examine the company and also the impact that the company's material financial distress would have on the economy as a whole—how severe that would be.

The way it works for a company is you get the notice, and you're asked to provide a whole lot of information to FSOC. FSOC also goes out and collects information about that company from state regulators and others, to understand the company.

AGENCY ACTIONS GET INVALIDATED BY COURTS EVERY WEEK UNDER THE ARBITRARY AND CAPRICIOUS STANDARD.

At some point, if it tentatively concludes that a company should be designated, FSOC issues a Proposed Designation Determination. The company has a certain amount of time to provide a rebuttal and then appear before FSOC in person and argue its case. And then FSOC reaches a final decision whether to designate, issues a final determination, and then the company is designated. That's the basic process.

Gallanis: *If a company gets that notification that it's a SIFI, what pathways exist under the law for a challenge to that designation, both administratively and judicially?*

Scalia: The notice you get is that you're being considered as a SIFI, although I think there is concern on the part of many that by the time you get that notice, the decision has been made. In the case of insurance companies, for example, the Financial Stability Board, which is an international body, had already designated the insurance companies that it considered to be globally systemically important by the time MetLife was designated by FSOC. And MetLife was indeed on that FSB list, as were Prudential and AIG. And lo and behold, all those companies ended up being designated as SIFIs by FSOC. I should add that some of the same people who participate on FSOC, either personally or through their subordinates, play

very significant roles on the FSB. So there's been a concern on the part of a lot of observers that by the time a company is trying to make its case before FSOC, at least some of the more powerful members of FSOC may have already reached a conclusion, and even made certain commitments in international forums as to what companies should or shouldn't be designated.

So with that prelude, once you've been tapped and told you're being considered, part of what you do is simply submit your evidence and your arguments. (I'm assuming you don't want to be designated.) You put them before the agency, explaining why you believe a designation is inappropriate. In MetLife's case, it made a number of points. One of them was that it thought designation would have a very severe impact on the company itself in a way that was bad for customers, shareholders, insurance markets, and MetLife's own well-being. So it's a combination of putting evidence and arguments and even legal arguments before the agency. And then if the agency ultimately does designate and you're dissatisfied with that, there's the ability to go to court within 30 days of the decision and challenge that determination as arbitrary and capricious, which is what MetLife did.

Gallanis: *So a company has to consider whether to bring an administrative appeal of the initial designation, and assuming that is unsuccessful, whether to pursue a judicial appeal, for which there is a specific pathway set out under Dodd-Frank. Can you summarize what sort of considerations might go through the minds of CEOs and company boards in making that tough decision?*

Scalia: I think on the one hand, it's appropriate that individuals or companies who feel they've been treated improperly by the government feel they have legal recourse and feel that if they take that legal recourse, their doing so will be respected. On the other hand, corporations, and for that matter trade associations, are not eager to sue the government. They worry about reputational risks. They worry about unfavorable treatment later by those government regulators. And it's unfortunate those concerns might exist, because people ought to be able to pursue their legal rights.

Gallanis: *I think everyone in this room is aware of the fact that, in the MetLife case that was brought at the Federal District Court here in Washington, ultimately there was a ruling that the SIFI designation was improper. But more precisely, could you describe to us the key holdings from Judge Collyer's opinion in that case?*

Scalia: There were essentially two. The first was that FSOC had unreasonably and without explanation departed from its own prior guidelines and standards. FSOC had said that part of its designation consideration process was assessing a company's vulnerability to material financial distress.

Gallanis: *This goes back to what you said earlier about one of the tests for SIFI designation—whether material distress at that company could pose material harm to the financial system. And then the question really becomes one of ambiguity: What is the likelihood that distress at that company could cause harm? Is that a question about some theoretical distress, or is it also a question of the likelihood that the company will encounter financial distress?*

Scalia: I would say the latter: the likelihood of the distress. You know, this shouldn't be an entirely fantastical, fictitious exercise. Congress doesn't require agencies to make consequential decisions and companies to suffer really great costs based on just utterly fantastical possibilities.

So FSOC itself said it was going to consider vulnerability. And yet when MetLife went through the process, the agency didn't. FSOC said, "Well, we don't consider that." To which MetLife responded, "But we just read your rules, and you said you would." And similarly, the judge ruled that FSOC had

> CORPORATIONS, AND FOR THAT MATTER TRADE ASSOCIATIONS, ARE NOT EAGER TO SUE THE GOVERNMENT.

improperly departed from its own guidance in the treatment it gave of the consequences that MetLife's material financial distress might have on its counterparties—people it has relationships with.

In the guidance, FSOC said it would consider whether there were significant adverse impacts. But they never made that determination at all in their designation of MetLife. They simply said that there are some entities that have high exposures to MetLife, be it equity or other trades that they have at MetLife, and if MetLife failed they could lose some money—without any quantification of what that might be.

In the last part of the court's decision, Judge Collyer ruled that FSOC had improperly failed to consider the consequences of designation for MetLife. This comes back in some ways to the cost-benefit point we discussed. MetLife had said this could have very serious adverse impacts for us, our customers, our shareholders, and the markets. And FSOC didn't address it. They said, "Well, that's not our concern," which was remarkable to me, because the CEO of MetLife, Steve Kandarian, had stood before FSOC—very powerful government officials—and said, "You should know that if this designation goes through, we are already looking at the possibility that we'll have to significantly change the company." That didn't matter to them, which was extraordinary. Look at what happened to GE Capital. It was designated and is virtually a shell of its former self now. MetLife has announced that it's going to exit the U.S. retail life insurance business. These are huge changes which the judge thought FSOC should have considered.

Gallanis: *I'm going to be sitting in this very spot tomorrow talking to Congressman Barney Frank, whose name is on the Dodd-Frank Act. And if I recall correctly, what he said about the experience at MetLife—post-designation, but pre-Judge Collyer—and the experience at GE Capital is that those companies restructuring themselves and so forth proves the wisdom of Dodd-Frank. That if companies will restructure themselves and change their fundamental business make-up to avoid designation as a SIFI, that means Dodd-Frank is working. Is there another perspective on that?*

Scalia: Sure—it's one I happen to have. There is a policy debate to be had about whether you should break up really big financial institutions. I'm not an expert on that. What I'll say is, if the government takes an action because it thinks it's a good outcome to force a company to break up, the government ought to say so. We shouldn't have unstated, secretive, collateral agendas. Let's have that debate. Let's say this is what we're doing, and here's why. That's not how these designation decisions are done. On the contrary, it was very remarkable to me to have these very senior federal regulators make a decision and say that the consequences of the decision were none of their business. I mean, usually you make a decision as a government regulator precisely and only because of the consequences.

The other thing I would say in response to Representative Frank, who by the way at other times has expressed concern about the designation of life insurance companies, is that if there's an objective of causing companies to downsize so that they avoid designation, let's have a clear road map. Because one of the deep concerns with FSOC's decision is that there are no clear parameters, standards, or guidelines. It's just sort of a gut reaction to a company by an agency. And so what Representative Frank evidently described won't exist until FSOC is far more clear about what warrants designation and

what doesn't, which hopefully will be one of the outcomes of this judicial process.

Gallanis: *So in the case of the MetLife ruling, that arbitrary and capricious standard that some characterized as an unbreachable wall appears to have been breached. Am I right that there was a finding by Judge Collyer that at least some of the actions of FSOC were indeed arbitrary and capricious?*
Scalia: That's right. And there were two essential elements of it, touching on three different things that FSOC decided. With respect to all those, the finding was that FSOC's action had been arbitrary and capricious. The judge didn't reach other arguments we made, but we said that FSOC was arbitrary and capricious in other ways, too.

Gallanis: *I know the case is on appeal, and Secretary Lew and others claim a great deal of optimism about their prospects. Assuming they're right and they get Judge Collyer's decision reversed, what happens to the other arguments that she did not reach?*
Scalia: They are still live arguments. The court of appeals can invalidate the designation on the grounds that were identified by Judge Collyer but on other grounds, too. So those are in play.

Gallanis: *In Judge Collyer's ruling, there was also a finding in essence that the required cost-benefit analysis had not been conducted.*
Scalia: Yes. Not so much a required cost-benefit analysis as a failure to consider the consequences of that action, including the costs and consequences for MetLife.

Gallanis: *There's another recent development where the boundaries of administrative agency authority in the financial services field have been extended and are now being tested, and it involves the Department of Labor's recently promulgated "fiduciary rule." What can you tell us about some of the challenges to the validity of that rule? You're representing clients in some of that litigation, and other lawsuits have been filed. What are the various challengers to the rule saying about the rule's validity and the process by which it was adopted?*
Scalia: The threshold decision that the Labor Department made in this package of rules was to significantly expand who is a fiduciary under ERISA and the Tax Code. So one of the principal legal arguments being made is that their interpretation of who is a fiduciary is just mistaken. In some ways, it comes back to the *Chevron*-type ideas that I was talking about—the argument is that you can't interpret the statute this way. The Labor Department will say, "We get deference." I think there are reasons they shouldn't. But that's the first argument: They vastly expanded the definition of fiduciary.

Expanding who is a fiduciary in these rulemakings was really, in my view, just a means to another end. That end was to impose a new regulatory code of conduct on IRA markets—on broker dealers and insurance agents who interact with IRAs. And the way the Labor Department did that was first, define this incredibly broad swath of the financial services industries as fiduciaries, at least when dealing with tax-favored plans as well as ERISA plans. And then to say, "We're going to give you an exemption from some of the prohibitions on fiduciaries, but only if you comply with a broad set of new standards we have, make a whole bunch of disclosures, and agree that you can be sued in class-action litigation by your customers under a so-called best interest contract."

So a second argument is that the Labor Department improperly used its so-called exemptive authority—its ability to relieve people of regulatory duties—as a means to impose regulatory duties. And also that it improperly created a private right of action—that it gave people a right to bring legal claims and seek damages in a way that the agency can't do. It comes back to the separation of powers concepts we discussed earlier. The Supreme Court has said that only Congress can create private rights of action; agencies can't do that.

There's also a First Amendment argument that's been made in the case; you see that sometimes in the context of litigation involving financial regulation. And again, there are arguments about costs and benefits, and also about how these fixed-index annuities in particular were treated by the Labor Department.

I find it a fascinating case, because the Labor Department has a pretty limited role when it comes to the financial services industry. But when you read its explanation for its rule, it's an Olympian judgment on virtually everything that goes on in the financial markets, including judgments about actively managed mutual funds, the utility of brokers, the appropriateness of proprietary financial products, and whether the disclosure requirements of the securities laws make any sense. These are not the kinds of things that you would expect the U.S. Department of Labor to be holding forth on. But they're very critical of current law and practices in all those areas.

Gallanis: *And when you speak about the purview of the Department of Labor, you speak with some experience.*

Scalia: Well, maybe I missed something when I was there. Maybe I had far more power than I ever knew. I missed out on a lot of fun.

Gallanis: *Are there other agency developments that somehow bear on financial services regulation or insurance that you'd recommend we keep a close eye on?*

Scalia: There is an interesting debate going on now about these principles of deference that I talked about earlier. Peter, you began our discussion talking about the debate going all the way back to the 1930s about the size and role of the federal government. That debate continues in one way or another today. What you're seeing a lot now is in the context of the question of how much deference courts should give to agencies.

And I think there's a growing sense that a number of justices on the Supreme Court believe too much deference is being given to agencies—that *Chevron* maybe is being applied too much. There are other principles of deference that I won't get into, that again a number of justices have questioned. So I think there's a very interesting dialogue going on right now about how long a leash the federal regulatory agencies can be on and whether they shouldn't be a little more accountable to Congress and the people they regulate and the people they're supposed to serve, in part through the courts.

Gallanis: *Are those issues likely to play out in the Supreme Court in ways that will generate some of the—if you'll forgive the expression—party line votes that we've seen on some other politically tinged issues? Or is this more of a cross-cutting issue where*

IF THE GOVERNMENT TAKES AN ACTION BECAUSE IT THINKS IT'S A GOOD OUTCOME TO FORCE A COMPANY TO BREAK UP, THE GOVERNMENT OUGHT TO SAY SO.

you might see different configurations of Justices voting together?

Scalia: One of the things I have liked about administrative law is it historically has not really favored one side or the other, liberal or conservative, business or environmental interests. Because if you're dealing with a deregulatory Reagan Administration and you're an environmental group, you want the arbitrary and capricious standard of review to have teeth and be meaningful. On the other hand, if you're dealing with a highly regulatory Obama Administration, for instance, and you're representing business interests, then again you favor an arbitrary and capricious standard of review that has real teeth. And I think the judges who apply these laws recognize this and tend to be interested in outcomes that—first of all—comport with the Constitution and with the statutes, but also that make sense over the long term, rather than in the context of a specific case. That's the way it ought to work and I think the way it usually works.

Audience Question: *Have you ever settled a case with the government, or is it always going to go to court?*

Scalia: I think that part of the administrative process is the hope that your differences get worked out during the rule-making. So I've participated in rule makings where we raised legal concerns, but there was no litigation because it got resolved in the final rule in a way that was satisfactory to everybody. And yes, there are circumstances where litigation is brought and there is a settlement later. The agency agrees, for example, to reconsider one part of the rule. It happens. And I've been on both sides of that: cases I brought in which there was a settlement, and cases when I was at the Labor Department that we settled. ✯

["Hot Time in the City" continues from page 1]

implemented." Kevin Rasch (MassMutual Financial Group) also cited the economy, calling the ongoing low interest rate environment "a pretty staggering experiment in economics." He noted that other countries have it even worse: "I heard an observer say that the U.S. economy is the best house in a bad neighborhood." Nonetheless, he added that "I'm pretty optimistic about the insurance industry."

Team USA: A. Thomas Finnell Jr. (Federal Insurance Office) praised the "Team USA" approach to representing U.S. interests in international regulatory discussions. "To me, it's working," he said. "On the international side, I hope FIO continues to play a pivotal role." He added that FIO holds regular calls with large companies to "set expectations" in regard to these discussions. "People don't know what to expect, so the anxiety level is quite high."

Pusey said that "from an industry perspective, we have to have success with Team USA." She added that while UK regulators contributed a great deal to international regulatory discussions, the recent Brexit vote isn't likely to derail those talks. "Some in the industry think this will set back the IAIS," she explained. "I expect the IAIS will still push through with ComFrame and the international capital standard."

Rep. Barney Frank

How's the Fed Doing?: Rasch believes the insurance expertise at the Federal Reserve is growing, especially at the top levels (he called Governor Daniel Tarullo's remarks at the May 2016 NAIC International Insurance Forum "a real watershed"). "The expertise is building there," he said. "Will it trickle down?" He essentially said that it had to, noting that "eventually you're going to have substantive policy debates, not a clip and paste of banking regulations." Picking up on his comments, Pusey added that "the industry was generally very positive" about Tarullo's remarks. "It was really important for the Fed to say, 'I'm just not comfortable with Solvency II.'"

The Guaranty System: Finnell praised the guaranty system for its "remarkable work" on insurer resolutions, and Pusey added that NOLHGA "puts so much substance on the field" in its dealings with Congress and other groups seeking information on the U.S. resolution process. Rasch agreed. "There's a great deal of expertise here," he said. "You can talk policy."

After emerging the clear victor in a

war of words with Richardson, moderator Susan Voss (American Enterprise Group) led a panel discussion entitled *The Changing Shape of International Regulatory Modernization and Progress in 2016 and Beyond*. Picking up on the discussion of the guaranty system in the previous panel, Daniel Rabinowitz (AIG Group) said that "we have every right to be proud of the regulatory system that has grown up in the United States for the insurance industry. We stand on bedrock when we talk about the American system of solvency regulation—regulators and guaranty associations."

Turning his gaze abroad, Rabinowitz said that "we believe in the evolution of global insurance standards" and stressed the importance of a capital standard. Looking at the NAIC and IAIS, "you will find a great confluence of opinion on prudential oversight of insurance companies," he said. "There's not a twopence's worth of difference. The piece that has lagged is capital standards."

Kevin McCarty (former NAIC President and Florida Insurance Commissioner) wasn't quite as enthusiastic about the international capital standard. "Looking at capital through one lens is like looking at the world through one political or social lens," he explained. "There's some benefit in diversification in how we look at capital." He stressed that the current work on the capital standard is far from complete—"we're not close," he said.

Gov. Dirk Kempthorne (ACLI) praised Federal Reserve Governor Tarullo's remarks indicating that the United States would follow its own path on the capital standard, saying that the EU needs to know where the United States is heading. "We'll use different means to get to the same place," he explained. He also predicted that work on a capital standard will be a lengthy undertaking.

Karen Shaw Petrou (Federal Financial Analytics) noted that assets can be treated differently across large enterprises and wondered how a capital standard would account for these differences. She also questioned whether the "complicated framework" of new regulations that have gone into effect in the last few years has made the system any safer. "We're building an edifice that only makes consultants happy," she said, adding that regulators are still wrestling with the question of how to resolve company failures without introducing moral hazard. In a failure, the priorities are "one, don't harm the innocent, and two, punish the guilty," she said. "We're miserably behind on the second part."

(From left to right) Kevin Rasch (MassMutual Financial Group), Leigh Ann Pusey (American Insurance Association), Christine Neighbors (Nebraska Department of Insurance), A. Thomas Finnell Jr. (FIO), and Charles Richardson (Faegre Baker Daniels) discuss domestic regulation.

The ACA's Annual Checkup

It's difficult if not impossible to have a discussion about insurance in the United States without mentioning the Affordable Care Act (ACA), and the 2016 Legal Seminar didn't even try. In *To Your Health: What the ACA Has Meant and Will Mean for Consumers and Health Insurers*, moderator Michael Adelberg (Faegre Baker Daniels) led his panelists through a discussion that touched on competition, rate filings, the dangers of adverse selection, and the current thinking in Congress when it comes to health care.

Commissioner Teresa Miller (Pennsylvania Insurance Department) kicked things off by saying that "the foremost issue on my mind these days is the rate filings." With some companies seeking increases of almost 50%, "I hear a lot of concerns about affordability when I talk to consumers." The difficulty, she added, is in striking the right balance between consumers and the industry. "Consumers are always at the top of my mind, but I also really want to have a competitive market." She added that because "people have more skin in the game now than they ever have," the need to educate them about provider networks and how their policies work is more important than ever.

Patricia Brown (Johns Hopkins HealthCare LLC) said that "the reform legislation and all the changes it's put into place have given providers more say in their destiny." For Johns Hopkins, that entails the hospital system also running its own insurance plan. Brown walked attendees through the history of Johns Hopkins HealthCare and highlighted a few events that she believed were relevant to struggles the industry has witnessed as the ACA has been implemented. During one enrollment period, "we began to bleed cash," Brown said. "These were people who didn't have health care before. We saw an unprecedented increase in utilization." She added that the utilization rates normalized in six to nine months or so.

In 2009, when the plan had to re-enroll patients electronically, "the sick people got on real quick, but the healthy people didn't care. It was an amazing adverse

selection phenomenon." Those experiences prompted Brown to caution attendees that health insurance "is not for the faint of heart."

Earl Pomeroy (Alston & Bird) actually voted for the ACA when he served in the House of Representatives, so he brought firsthand experience to his discussion of the forces driving Congress's thinking on health care. "The parties agree that cost containment through reimbursement reform is a good thing," he said, which means a drive toward "value, not volume" in reimbursement. There's a bipartisan push to innovate the reimbursement system. "It's breathtaking, the kinds of changes we'll see," he added. "All hell's going to break loose."

Where Congress doesn't agree, he said, is on who should bear the risk in the market. The Republicans want to move the risk to the states and individuals to protect the federal budget, and this philosophy can be seen in their criticisms of the ACA as an expansion of risk and in the way they seek to reform Medicare and Medicaid. The Democrats, on the other hand, want to reduce the risks to individual consumers. Pomeroy didn't express much optimism that this disagreement could be worked out: "There's a Grand Canyon divide over where the risk should go."

Speaking of risk (and we were—just read the last paragraph again), that word was used repeatedly in the presentation *Methods to Resolve Conflicts Between Insolvent Estates and the Federal Government*, since many of these disputes involve not just the ACA but the risk corridor payment program that the Act created. As moderator Franklin O'Loughlin (Lewis Roca Rothgerber Christie) put it, "we keep running into federal issues we thought were resolved decades ago."

The conflicts involve the federal superpriority statute and the stance taken by the government in some cases that the McCarran-Ferguson Act (which grants to the states the power to regulate insurance) doesn't apply to companies founded under the ACA. Robert Nunnally Jr. (Wisener Nunnally Roth), who has worked on the SeeChange Health Insurance Company (California) insolvency, said that "the United States claims it has what I call Class 1.5 priority, right behind administrative costs" and ahead of policyholders. "In the old days, we just looked at *Fabe*," he added, referring to the ruling that held that the federal priority statute did not preempt state insurer insolvency law. Not in this case, he said, because the federal government has argued that the California receivership statute interferes with the administration of the ACA. "That's where the battle lines are drawn."

Daniel Rabinowitz (AIG Group), Karen Shaw Petrou (Federal Financial Analytics), Gov. Dirk Kempthorne (ACLI), Kevin McCarty (former NAIC President) and Susan Voss (American Enterprise Group) on the international regulation panel.

Douglas Schmidt (Husch Blackwell) said that "the government has become the financial founder of the CO-OPs" created by the ACA. As a result, "the government is going to be taking a much larger role in all these insolvencies." In the case of CoOportunity Health (Iowa), the state of Iowa has sued the federal government under the Administrative Procedure Act's arbitrary and capricious standard over risk corridor payments that Iowa believes should be made to the CoOportunity estate.

The state of Colorado took a different approach when the CO-OP in its state failed, according to Michael Conway (Colorado Division of Insurance). Instead of filing suit, the state filed a request for reconsideration of its claim to risk corridor payments under the ACA. While the appeal hasn't been ruled on yet, Colorado has received some payments from CMS. The tricky part has been determining why the money was distributed. Hinting at some confusion among the various federal entities involved in these disputes, Conway said that "the consistent answer from CMS was, 'I don't know.'"

Appeals & Attacks

Another panel—*The World of Appellate Practice and Strategy*, moderated by NOLHGA's Bill O'Sullivan—also dealt with the concept of reconsidering decisions—in this case, ones made by a court instead of a government agency. Catherine Masters (Schiff Hardin) began by saying that "appellate practice is part art, part science" and then went on to explain the science—how the appeals process actually works.

Masters said the appellate court "usually deals with questions of law, not fact," adding that "the court's role is not to second-guess the trial court." Questions of

fact, when they are reviewed, are handled "very deferentially." The appeals court can review the legal conclusions of the trial court (a *de novo* review), in which there's no deference to the original ruling: "It's a complete do-over." The court can also review discretionary rulings, but Masters warned that abuse of discretion has to be "eye-popping" to merit reversal.

Masters stressed that the appeals court usually doesn't consider evidence not offered in the trial itself. "In the course of the trial, you need to have an eye toward issues of appeal," she explained. "The appeal starts during the trial." She added that it can be helpful to have an appellate member of your trial team "looking over your shoulder" to ensure you're not missing anything during the trial.

Pamela E. Olsen (Cline Williams Wright Johnson & Oldfather) handled the "art" of the appeals process—how to craft an effective appeal. "The really important piece in going from trial to appeal is the communication that occurs," she said. "You go from live communication to very cold paper." The key, she added, is to "transition that cold record into a living story" in the brief you file with the appeals court.

Appeals sink or swim on the quality of that brief, Olsen said, recalling a judge she clerked for who said, "you can win on the brief and lose on the oral argument, but very rarely can you do the opposite." The key in structuring the brief is to cite what happened in the record and why it was wrong—and not to get too flowery when you do it. "Adjectives and adverbs mean nothing to appellate judges."

You know who else doesn't care about adjectives and adverbs? Computer hackers, because those words aren't used in the coding for the viruses that steal data or lock a company's computer system till a ransom is paid. In *The Evolving Market for Cyber Insurance*, moderated by Jack Falkenbach (Delaware guaranty association), Kim Quarles of Willis Towers Watson and Garin Pace of AIG explained the cyber threats companies face and how insurance can help.

Quarles began by reminding the audience that "all of us will be hacked at some point in our lives." She noted that the cyber insurance marketplace, which is only about 15 years old, stands at about $2 billion today but is expected to reach

Captive Audience

Stephen Taylor, Commissioner of the District of Columbia Department of Insurance, Securities and Banking, welcomed Legal Seminar attendees to the Nation's Capital by singing the legal and economic praises of the host city and also highlighting some of the top priorities of the NAIC, such as long-term-care insurance and the broader issue of paying for retirement. "We need to find a new approach to ensure retirement income security for seniors," he said. He also pointed to the NAIC's work on a covered agreement with the European Union and the extensive work being done on cybersecurity.

Closer to home, Commissioner Taylor said that his department is focused on fraud issues and has begun staging "financial fitness clinics" to educate residents on various financial matters. He also noted that the District of Columbia was working with regulators in Maryland and Virginia to create what he called a "regulatory powerhouse" in the region.

Commissioner Taylor cited the District as "a world-class captive jurisdiction," and the head of the department's captives bureau, Dana Sheppard, was on hand to discuss the District's approach to captive regulation and how the captive market has blossomed in the last decade (the District of Columbia is home to Guaranty Association Benefits Company, the captive formed by the guaranty associations to administer policies from the ELNY estate).

The District has licensed 221 captives since 2001 (131 are currently active), and Sheppard walked attendees through the various types of captive structures: single parent, branch, group/association, risk retention group, and protected cell. He explained that the District "passed our captive law for economic development," and he noted that captive regulation was quite different than traditional regulation. "We have 'business plan' regulation," he said, in which the business plan for the captive determines how the company will be run "and you have to tell your regulator if you plan to change anything."

Commissioner Teresa Miller (Pennsylvania Department of Insurance), Patricia Brown (Johns Hopkins HealthCare), and Earl Pomeroy (Alston & Bird) participated in the ACA panel moderated by Michael Adelberg (Faegre Baker Daniels) (not shown).

about $20 billion in 2020. Insurance covers a number of things, from preventing hackers from gaining entry to your systems to what to do when they succeed. "It's critically important that you have legal advice" when a breach occurs, Quarles said. In addition, "your public relations response in those first hours is critical." One of the key facets of cyber insurance is that it gives companies seeking both protection against a breach and advice on what to do if a breach occurs anyway "one-stop shopping" for all the services they'll need. "Your cyber carrier is a partner with you."

Looking at emerging threats, Quarles confirmed that people are still the biggest tech problem a company can have. "Human error is always a big deal," she explained. "We've seen it cause the bulk of cyber liability claims." She added that "the average large business has 2,000 unique mobile applications being downloaded by their employees daily." Professional hackers even advertise the quality of their services on what Quarles called "the dark web," complete with price lists and promises of effectiveness.

Pace emphasized that cyber insurance works with a company's cyber capabilities—it doesn't replace them. Securing data "is an enterprise problem, not an IT problem," he said. One key capability is identity and access management. "A few years ago, we used to say 'build more castle walls,'" Pace said. "That's getting harder." He added that two-step authentication is a great way to make things difficult for hackers.

One of the key aspects of securing your company's data, Pace said, is disposing of data you don't need. "Once data has outlived its usefulness, get rid of it and reduce your liability." Companies also need to do a risk assessment—in other words, ask themselves "what do we have, and who wants it?" Cyber insurance can help in all these efforts, he said. "Carriers are increasingly looking to make their customers better risks."

We're from the Government & We're Here to Help

One of the unstated themes of the 2016 Legal Seminar seemed to be the federal government's expansion into various segments of the financial services market. That was certainly the subtext of *Companies, Agents, Consumers: Meet the DOL Fiduciary Rule*, a panel discussion moderated by Patrick Hughes (Faegre Baker Daniels) on the Department of Labor's new fiduciary rule. As the title of the panel indicates, the rule—which ropes insurance agents into the "best interests of the client" definition of "fiduciary"—is expected to affect all parts of the insurance pipeline.

When asked what the rule means for the insurance industry, Michael Consedine (Transamerica) replied, "We're playing a part in *The Hunger Games*, and someone's volunteered us as tribute." Unlike *The Hunger Games*, the fiduciary rule isn't intended to kill anyone, and Consedine listed some positives of the rule's implementation. "We have no problem with a 'best interests' standard," he said, adding that "consumers will get the benefit of a more level playing field, and we get the chance to take a fresh look at how we interact with customers."

The bad, however, seems likely to outweigh the good. If producers decide the rule is too unwieldy and simply stop selling insurance products, "we might have an advice gap" that leaves consumers with no help in choosing financial products. In addition, Consedine said, "any company dealing with this is spending millions upon millions of dollars."

Scott Campion (Oliver Wyman) said that companies preparing for the rule's implementation need to figure out their compensation and incentive structure, which will change radically with the new rule. They also have to analyze their product offerings to determine "which products will succeed in a 'best interests' world."

Companies should also keep their eye on the courts, because there are several lawsuits opposing the rule, according to Phillip Stano (Sutherland Asbill & Brennan). "As hard as it is to litigate these cases, it's a lot harder to comply with the rule," Stano said. Though Campion and Consedine said that company preparations have advanced too far to go back (Consedine said successful litigation

would be "sort of a Pyrrhic victory," and Campion said "fiduciary is coming" even if the rule is overturned), Stano said the suits are necessary. "You can't have a regulator create a fiduciary standard for you—I think you have to fight it," he said. "We know who's going to be enforcing this—the plaintiffs' bar. You can't run your business that way."

Consedine warned that more changes are on the way. "It doesn't stop here," he said. "Other regulators are somewhat emboldened by the Department of Labor's success." Stano agreed: "If the department is successful, everyone's going to want to get their finger in the pie."

Another presentation—*Taking Stock in Related-Party Debt: Life and Health Insurers Confront New Issues Under Treasury's Proposed Debt-Equity Regulations*, introduced and moderated by Charles Gullickson (South Dakota guaranty association and Davenport Evans Hurwitz & Smith)—explored the potential impact of another action recently taken by the Treasury Department, in this case the IRS. William Pauls (Sutherland Asbill & Brennan) provided attendees with an overview of new proposed regulations from the IRS on the tax treatment of related-party debt. Pauls took the audience through the implications, potentially quite negative, to insurers on their surplus notes, debt instruments, and reinsurance transactions. Heavy—but important—stuff. ✯

Sean M. McKenna is NOLHGA's Director of Communications. All meeting photos by Kenneth L. Bullock.

["Rep. Barney Frank" continues from page 11]

strength, not her weakness. This has been a year when any institution or individual with a record of deep involvement in government is in terrible shape. People say, "Look what happened to Hillary Clinton." Well, she did a lot better than British membership in the European Union and Jeb Bush. I mean, people hate anybody who's done anything for the last 20 years. She has survived that anti-establishment feeling.

We have an interesting definition on the Democratic side of who is in the establishment. Apparently on the Democratic side, the establishment consists of anybody who has been a long-term member of Congress with the exception of Bernie Sanders, who is now in his 26th year in Congress but is apparently an outsider.

Donald Trump's unpopularity is significant. The Electoral College map looks good for us, and I would say this. She had a dip in the polls—she never went behind, she went even. That was right after FBI Director Comey had attacked her and Bernie Sanders hadn't endorsed her. I think the Sanders endorsement undoubtedly bumps her up a couple of points. And I think once again, that Donald Trump has kind of a lack of discipline.

For example, and other people have commented on this—this announcement that we may not defend NATO countries is going to reinforce a lot of Republican unhappiness. So I think she will win. I also think the Democrats are likely to take back the Senate. In the House, we will narrow the majority, but not take it back.

By the way, one reason I think she's going to win. People can say what they want about who's going to carry what state, but in the key states that are undecided—the states that Trump wants to win—the Republican Senators seem to think he's unpopular. And particularly with regard to Ohio, I have to say this. No Republican has ever won the presidency without Ohio, and I think it's awfully hard to win a state when the Republican Governor of that state clearly hopes you're going to lose. If you're John Kasich, and you're the Governor of Ohio, and you have said I can't support this guy, and the campaign is attacking you, do you really want your state to vote for the guy over your obvious objection?

Audience Question: *What is your opinion of negative interest rates?*

Frank: I am very skeptical. I would have to have an awful lot of cash before I would submit myself to them. I think I would go try to find some other country. I think the quantitative easing has worked well, and I think Ben Bernanke had a very successful run. And one of the striking things is the continuity in the policy there. But I'm very skeptical of negative interest rates; I don't think they incentivize people.

I guess the notion is, rather than have negative interest rates, you'll go out and lend the money. I doubt very much that people are going to make loans that they otherwise weren't going to make to avoid that kind of a penalty.

The Fed asked Congress, under Mike Oxley, when we were still in the minority, to give the Fed the power to pay banks interest on the money they deposited in the Fed. Until 2005 or so, they didn't get any interest on that. And Bernanke asked us to give him the power to pay interest. People said it's a big favor to the banks, but no—it's a management tool, because the Fed now has the power to raise or lower the interest rate it charges banks, and that can have an effect as an incentive. And in the crisis, we sped that up for him. So I do understand that, but I don't understand how negative interest rates are supposed to work, and I'm very skeptical of them. ✯

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

This case has, however, resulted in questions being raised about the assessment process. LTCI is treated as health insurance in the statutes of every guaranty association. Yet, as mentioned earlier, the bulk of LTCI has been written by life and annuity writers. There is concern among health insurers that they will be called upon to pay a large part of the guaranty association costs for a product line with which they have had comparatively little involvement. As a result, they have proposed changes in the assessment process for LTCI. Life and annuity writers, not surprisingly, are sensitive to changes in a system they know well, and that has worked well for decades.

The familiarity that life and annuity writers have with the state guaranty system is not shared by many health writers. Health insurers—especially large national carriers—have not had much in-depth contact with the guaranty system, since no nationally significant health insurer has to date failed in the four-plus decades in which life and health guaranty associations have existed.

Health insurers are now quickly developing experience with the guaranty system. But not having previously known the system, and not having the experience with the system that life and annuity writers have developed over four decades and through a number of major cases, they have had to learn "on the fly" as the insurers and the guaranty associations have worked toward the resolution of this significant upcoming insolvency.

And, of course, we in the guaranty system have had to learn as well. This case—like so many insolvencies through the years—has called on us to adopt new approaches to overcome new challenges. Because of the significant experience and large financial stake of the health insurers, they will play a larger role in crafting and administering the resolution plan than has sometimes been the case in prior resolutions.

As the health insurers have "learned" the guaranty system and the system has "learned" the issues facing the insurers, there have been some inevitable rough spots. They remind me of the growing pains that companies might expect when executing a merger of two successful but previously unacquainted "corporate cultures." As in a good merger, the coming together of these two cultures should produce a stronger, better organization.

Former New Jersey Insurance Commissioner Holly Bakke's favorite aphorism was, "Don't let the perfect become the enemy of the good." It is only natural, in crafting a resolution plan, to pursue the perfect—the ideal plan that will meet everyone's needs.

That dream cannot always become a reality, and holding fast to some dream of the ideal can result, in the real world, in a resolution process that might not best serve the people for whom the system was created in the first place—policyholders. The interests that we in the guaranty system share with the other stakeholders examining the LTCI marketplace are much more important than whatever areas in which our perspectives may differ. We must find a way to engage each other creatively and responsibility, working together for the sake of all our stakeholders. ✯

Peter G. Gallanis is President of NOLHGA.

NOLHGA Calendar of Events

2016

October 25	**MPC Meeting** **Dallas, Texas**
October 26–27	**NOLHGA's 33rd Annual Meeting** **Dallas, Texas**
December 10–13	NAIC Fall National Meeting Miami, Florida

2017

January 4–5	**MPC Meeting** **Scottsdale, Arizona**
April 8–11	NAIC Spring National Meeting Denver, Colorado
April 20–21	**MPC Meeting** **Louisville, Kentucky**
July 18–19	**MPC Meeting** **Chicago, Illinois**
July 20–21	**NOLHGA's 25th Legal Seminar** **Chicago, Illinois**
August 5–8	NAIC Summer National Meeting Philadelphia, Pennsylvania
October 8–10	ACLI Annual Conference Orlando, Florida
October 17	**MPC Meeting** **Charleston, South Carolina**
October 18–19	**NOLHGA's 34th Annual Meeting** **Charleston, South Carolina**
December 2–5	NAIC Fall National Meeting Honolulu, Hawaii

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