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nolhga journal

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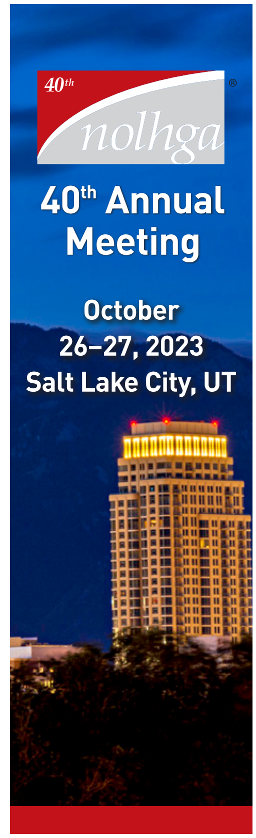
Higher Learning

NOLHGA heads up—and up—to Salt Lake City for its 2023 Annual Meeting.



By Sean M. McKenna

Salt Lake City is approximately 4,300 feet above sea level, if Google is to be believed. Judging from my headache during most of NOLHGA's 40th Annual Meeting, Google can be trusted.

Despite the height and the headaches, more than 100 people made their way to Salt Lake City in October 2023 for the meeting, with a sizable cohort attending online as well. Over two days, they were treated to interviews with new NOLHGA President Katie Wade as well as key figures in the life and health insurance markets, presentations on pension risk transfer transactions and the history of collaboration between NOLHGA and the ACLI's Receivership Committee, and a fascinating outlook on the U.S. economy.

The schedule also included annual meetings for LTC Re and GABC, task force briefings on some of the larger receiverships NOLHGA is dealing with at the moment, an MPC meeting, and a truly memorable luncheon speech by noted author and journalist Ron Suskind.

All in all, it was quite a meeting. Looking at how much took place over just three days, maybe the elevation wasn't to blame for my headache. It's possible my brain was just too full.

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ALSO IN THIS ISSUE

President's Column by Katie Wade

A Supportive & Collaborative Place

This is my first *NOLHGA Journal* column, and I want to start by saying that I am honored to have been chosen to serve as NOLHGA's new President. I joined the organization at the end of August 2023, and since then I have been getting up to speed on NOLHGA and the role it plays in supporting its members in managing insolvencies. What I have found—and this will come as no surprise to longtime members of the guaranty system community—is that the guaranty system is an extraordinarily supportive and collaborative place, where people are not shy about rolling up their sleeves and doing the work.

As all of you know, there is work to be done, with two large receiverships and several "legacy" cases winding their way down. When I look at the challenges and opportunities facing the guaranty system, I am reminded of one of the first lessons I learned in speaking with so many of you: The associations, NOLHGA, and our Members' Participation Council (MPC) work best when we work together. And we can only work together when NOLHGA remains focused on understanding and appreciating the varying needs of our member associations and being responsive to those needs.

That focus is the driving force behind many of the initiatives we have pursued over the last few months. At the January MPC meeting, we engaged in the first step in an extensive strategic planning initiative with administrators from almost every guaranty association. The feedback we received during that session will be used to structure our three-year strategic plan, which will position NOLHGA to better serve our members this year and in future years. You will be hearing more about this project over the next few months.

Even before that session, our members were asking for education on a number of fronts, both in insolvency task force work and in the day-to-day operations of a guaranty association. By the time you read this, NOLHGA, with the participation of many of you, will already have conducted three educational sessions in 2024—two on annuities and one on educating new Board members—and we have a full curriculum planned for the rest of the year, with sessions on assessments, succession planning, the MPC's new Model Plan of Operations, and more.

Strategic planning and these educational programs are just two facets of our work to ensure system resilience and sustainability. This resilience—in people, processes,

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and technology—is a key priority for NOLHGA. Guaranty system leaders have been talking for several years about the changing face of the system and how many of our most experienced members are nearing retirement. How do we harness that expertise before it leaves the system, and how do we welcome newer members into the system quickly so they can benefit from it? Facilitating knowledge transfer—through educational programs, lessons learned reports, and our work on an orientation program for new guaranty association administrators—is the key to fostering system resilience.

This focus on sharing knowledge runs through many of our 2024 projects. Based upon feedback from our members, the QUEST online insolvency library will be redesigned, with a focus on making information easier for users to find. The NOLHGA website will get a long-needed "facelift," both to modernize the look of the site and to make it easier for visitors to find exactly what they need without having to wade through the impressive amount of information the site holds. We will also revamp the content of the site so that users—especially those without 10 to 20 years of experience in the insurance industry—can understand what we do and how we do it. Guaranty association work is complex, and we need to explain it so that people who need our help can understand it and know that our members are there to help them.

In every project we pursue, NOLHGA will work with our members to be sure that we are meeting their needs and helping them perform their vital role of keeping the promises of the insurance industry.

Of course, our members do not do this in a vacuum. They work with the industry and with regulators, and that is why NOLHGA works to educate stakeholders on the system and its value to consumers nationally and internationally. NOLHGA is building and strengthening relationships with regulators by engaging in collaborative discussions and frank dialogue on insurance resolution and how the guaranty system can work together with regulators and receivers to best serve consumers. In addition, NOLHGA works to educate other stakeholders on how the state guaranty association system works and how it works together with the state-based system of regulation to protect consumers.

The Legal Seminar is one of the best examples of another key function for NOLHGA—keeping abreast of emerging issues that impact the system, including new products and innovations and industry trends, and sharing that information with our members. We are doing our best to cast a wider net for this year's Seminar, identifying new topics, Planning Committee members, and consultants to provide the best program possible. I hope to see many of you in Boston on July 25th and 26th. The program is still taking shape, but NAIC President and Connecticut Insurance Commissioner Andrew Mais and Rhode Island Director of Business Regulation Beth Dwyer have already agreed to speak.

I want to emphasize that as we embark on these projects, we are not taking our eyes off the core mission of NOLHGA—insolvency management. That will always be job #1 for the NOLHGA team, and the best way for us to accomplish it is to give our members the support they need. We are working to do that every day, but we need your help. If you have thoughts about the projects I have mentioned here or have other suggestions, please do not hesitate to contact me at kwade@nolhga.com.

The state life and health insurance guaranty associations have a long and proud history of protecting policyholders, and I am pleased to say that the associations stand ready to continue this tradition well into the future. I am honored to play a part in it. ✯

Katie Wade is NOLHGA's President.

NOLHGA Conversations

THE FUTURE OF HEALTH CARE

Mark Bertolini, CEO of Oscar Health, discusses the difficulties of entering the health care market, the outlook for the ACA, the mental health crisis in America, and more.

Mark Bertolini is the CEO of Oscar Health, a company that serves nearly 1 million members in the individual and family, Medicare Advantage, and small group plans. He's the former Chairman and CEO of Aetna and the former Co-CEO of Bridgewater Associates, the world's largest and most successful hedge fund. I have been lucky in my career because I've had the opportunity to work with Mark twice, once when I was at Cigna and then when I was insurance commissioner and he was the CEO of Aetna. Mark is one of the brightest minds in health care, and he was kind enough to speak with me (virtually) at our Annual Meeting in late October 2023; what follows is an edited transcript of our conversation.—Katie Wade

Wade: Can you tell us about Oscar Health?

Bertolini: One way to think about Oscar is that we're a tech company with an insurance company laboratory. We have a unique operating platform that we built over the last 11 years that is one of the only, if not the only, front-to-back platforms with a single source of truth on each data point that the industry has ever used. As you know, Katie, when we worked together at Cigna and then when we were partnering when I was CEO of Aetna, the technology platforms in the health insurance industry have been around for 50 years. The systems are dated. The data is all over the place. And quite frankly, it leaves the industry a little further behind on large language models and artificial intelligence versus other industries. So if we think about Oscar, first and foremost it's our technology stack that will drive a differentiation.

Second, we believe the market is going to become increasingly individual and digital. As a result, we find ourselves very well positioned on that point. We have a net promoter score, or NPS, of 57, while the insurance industry averages zero. We think we have a unique opportunity to drive a digitization and individualization of the market over time.

And finally, we've got a great growth trajectory. The company hadn't made a profit until the last two quarters, and we're now generating a profit and a margin, which is important, as you all know, in being able to bolster reserves and preserve the stability of the firm, particularly as it relates to our customers.

Wade: Can you talk a little bit more about the technology stack? It's really interesting what Oscar has been doing in trying to help people get doctor appointments and other things.

Bertolini: I'll start first with our intake process. Our most profitable benefit plan in the Affordable Care Act marketplace is our plan that attracts and treats diabetics. And the reason is that we have a great way to do virtual home assessments. We bring people into what we call our campaign builder and begin to engage them around how to take care of their care. We can make appointments for them. All that technology on the front end of the business gets people to the right place.

Secondly, we can give great information from the back end of the business on what has happened and how it has happened. It's now all available on an app for Oscar where people can see their claims in plain English and understand how they were processed. Their EOBs make sense.

Third, and probably more importantly, Josh Kushner and Mario Schlosser, who are the founders of Oscar, knew Sam Altman when they were at Harvard. We've been using a lot of OpenAI's technology for a number of years, and we find ourselves ahead. We are very cautious in that area of the market, in that area of the technology stack. So we do a lot on the back end to make things efficient and pay quicker claims and make sure that we're paying them properly. We have a number of large language models that we've implemented in the back end of the business, which has helped with our efficiency.

THE TECHNOLOGY PLATFORMS IN THE HEALTH INSURANCE INDUSTRY HAVE BEEN AROUND FOR 50 YEARS. THE SYSTEMS ARE DATED. THE DATA IS ALL OVER THE PLACE.

On the front end, as it relates to patients and members, we're very cautious about the kind of insights and decisions we make there. We always have clinicians involved. We actually have an oversight committee that reviews our use of artificial intelligence as it relates to working with members and working with patients.

Wade: Oscar is a fairly new entrant in the market. With the ACA, we saw some of the health insurance CO-OPs face some challenges. We've seen some newer entrants having some challenges that we're working on right now in the guaranty system. Can you talk to us about the challenges and opportunities of being a new entrant? And can you touch on risk adjustment, because that can be more challenging for new entrants?

Bertolini: I think health insurance expertise is an important part of what you need to understand how a good health insurance company should run. For the member experience, but even more importantly, from the standpoint of the

stability of the firm and its ability to stick in the marketplace and not have to pull in and out. We've seen a couple of cases where companies actually have to withdraw from everything to stabilize the firm. So that's important.

Secondly, it's the attention to detail. We've seen some of these other firms grow at any expense. We know what the underwriting cycle used to be—buy business, price it up, capture as much as you could, go buy business. There was a three-year underwriting cycle. That cycle doesn't exist anymore, in large part because of the minimum loss ratios that the ACA put in place. You can't buy business and price it up later. There's no way to recover. So those who thought, "let's get in, get a lot of share, and move ahead" without really making sure that the business was run properly find themselves in financial trouble.

On the risk adjusters, it's really about collecting data. And again, if your data is all over the place and you're trying to gather it in a way to make the risk adjusters work, you can't effectively manage that part of the business. We not only have used a number of vendors, but we now use artificial intelligence and large language models that have actually improved the quality of our risk adjustment inputs, so that we're making sure that we're giving the right data to the regulators. Interestingly enough, we've been a net payer every year since we started business and still believe that we'll be a net payer going forward.

Wade: I'd like to get your perspective on where you see the health insurance market going, in particular the current and future economic outlook for health insurance; Medicaid redetermination; tightening state budgets; employer cost cutting; what drives health insurance premiums—it's health care costs, and they're rising—and how employers are thinking about their benefits.

Bertolini: Let's start with the ACA. Most importantly, its size now matters. I don't think it's going away anytime soon. There may be some impact subsidies at the high end of the market, which I expect depending on the political outcome of the next election—that may be something that gets in the way. It has to be renewed—as you all know, it sunsets. And so we're not relying on that being there when we go forward. However, if you go back to 2006 and 2007, when everybody was sure Congress was going to kill the Medicare Advantage program, we said if we could get to 20 million, we could preserve it because it would be too big to kill. And that's exactly what's happened. And now it's growing even faster.

Now we see the ACA approaching 20 million, and we believe once it hits that number it's going to be really hard for anybody in Congress to kill this program. Also, speaking now as Co-Chief Executive Officer of Bridgewater Associates, it's very clear, with what's going on with quantitative tightening and inflation and GDP growth, that the Fed is going to have to hit rates probably one or two more times. If that occurs, I think there's a very high risk of a deep recession, which is going to put people out of work. That is going to make the ACA even more important for people to get coverage.

The second part I would also note is that if you look at the fully insured health care marketplace, 70% of it is now individual. It's Medicare, Medicaid, and ACA. There's 30% left. It's small group and middle-market employers who are being deeply impacted by the economy and employment issues. At Oscar, we are starting to prepare to be ready to have an individualization of those two markets as well. I've always been a believer that ultimately the employer-sponsored health insurance market will go away. I think we're getting close to that opportunity.

Even though ICHRA (Individual Coverage Health Reimbursement Arrangement) was implemented in 2019, I don't think it's been properly proposed to the marketplace. Number one, because employers are afraid of sick people in the group driving up the overall defined contribution and, as a result, having no control over the benefit. And secondly, and probably more importantly, how will the employees react? How will we take care of those sick people who are in the groups?

With our emerging technology platform, which for diabetics is working really well, this year we are launching Breathe Easy for COPD and for asthmatic patients—again, trying to control these chronic disease states that drive health insurance premiums and health care costs up. We believe if we can do that effectively, we can go to these smaller employers and say, "most of your employees are over-insured. Let's find a way we can give them more choice and let them buy what they need." And on the other side, let's assure you—the employer—how we're going to take care of the sicker people in your population so they don't drive your defined contribution costs way up.

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If we can make that value proposition, we believe we have a huge opportunity to convert that marketplace—35 million people—into an individual market. Which we think is the best place for Americans to purchase their health care.

And finally, at the state level, Texas is now considering their own health insurance exchange. In state-based markets, why wouldn't we have just one marketplace for individual coverage—Medicaid, COBRA, ACA? It would make the best opportunity for employees to be able to maintain coverage and maintain their network affiliations if indeed they could have access to it all in one place. We're interested in this, and we're now looking at how we could affect that change—what kind of proposals could we make to all of you on why it makes sense to have one individual market regardless of the funding mechanism?

Wade: When I was commissioner, I would get blamed for health insurance cost increases, and I would remind people that I only regulated 15% of the market. There are structural barriers that legislators and regulators and others are going to have to work through in your concept of bringing the pool together. Do you view the exchange as the vehicle to bring it all together?

Bertolini: Yes. Having one marketplace—I think we've proven that individual insurance can work. And I think we've proven that there are mechanisms we can use to properly price the business and also to properly adjust the risk. Now we need to think about larger populations that will provide even more stability to those pools.

Wade: As health care costs have gone up and presented some challenges to rate review, we're seeing a little bit of politicization and some rate suppression, which obviously has significant solvency implications and challenges, particularly for smaller players in the market. I wanted to get your perspective on that.

Bertolini: I think rate suppression is an issue in specific markets, and as a result, we don't participate in those markets. I would like to participate in those markets.

Even more interestingly, we're doing now what I would call an exurban expansion. We now can look at markets where

we have really solid relationships with our provider networks that extend into communities outside of major metropolitan areas, and if the rate structure is right, we can actually get to exurban or rural health care coverage for the ACA. Which is a huge hole in the market for a lot of coverage.

We would like to find ways to work with regulators to help understand how to take care of all those populations—not just cherry pick the markets where the rates are right. I had the team look this information up for me a few months ago. ACA subsidies are three times what people thought they were going to be back in 2010. But because we have lower membership than people thought we were going to have in 2010, overall costs are at or just below the expected total costs for this time frame. It's an interesting dynamic and an interesting way to think about this: how could we get more covered, and what can we do in markets where rate suppression as a political issue is getting in the way of taking care of people who need their health care?

Wade: We're coming into an election year next year—how are you thinking about your business? You touched upon the fact that the ACA is here to stay and it's going to be hard politically for it to go away. What are your thoughts about which issues are going to be discussed next year and what might happen?

Bertolini: You all are closer to it than I am, but I don't know that Congress can get anything done these days, let alone having to make hard decisions. So I'm not counting on the federal government having a positive impact one way or the other in the next election cycle. I don't know what will break the logjam and have people open their eyes as to what really needs to be done for the American people. At the moment, I think the subsidies will go away because Congress won't be able to act on that. They'll sunset at the high end of the market, at the higher end of the federal poverty level. Other than that, I don't see much changing.

Wade: What about Medicare and Medicare Advantage?

Bertolini: Here's an interesting dynamic. We were involved at Aetna early on in 2005 when I met with Mike Leavitt [then–Secretary of Health and Human Services], and he said, "how do we get you people to take on more risk, to take care of the sicker people?" And I said to him, "in the last cycle, the rates were all the same. If we had risk adjustment, we could make it work." When we put together the risk adjustment mechanism, we found that 75-year-olds with three chronic co-morbidities, if we just bolted a nurse to them, had five times the margin associated with them than 24-year-olds who never used their health care.

If you look at the industry trajectory and the big insurance plans, some of the margins are up at 8% pretax. And when you look at an 8% pretax margin, it's driving 60% of the margin improvement in the big insurance companies, with only 20% of the membership. There's a cross-subsidization going on inside those companies. Meanwhile, the health systems are failing. The margins for Medicare are minus 3% at best.

At Oscar, we've got a conversation going on with a with a large health system. What if we used our technology and we went to these systems and said, "we'll put you in the business of having a locally branded Medicare Advantage product where you sign up your patients. We'll partner with you on both the platform and the risk. And we will put you in the Medicare Advantage business." And while the federal government and CMS are pushing pressure down on risk adjusters, given how much money the insurance industry is making—let's call it 5% instead of 8%. If it's 5% pretax margins and the health systems are at minus 3%, that's an 8% switch on 50% of their revenue. We could improve hospital margins by 4% just by putting it in the Medicare Advantage business. We think that's a great place for Oscar to be in the business

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and to change the way the country offers coverage for Medicare enrollees.

Wade: When we talked about new companies entering the market and the challenges they faced, you talked about some companies not having much health insurance experience. You were obviously brought in to Oscar to bring that. What were some of the biggest surprises when you joined the company?

Bertolini: Just the simple stuff—fraud, waste, and abuse. We have a big presence in Florida. It's 3% to 5% in South Florida. We weren't collecting anywhere near that. We weren't looking at it that way. And it was because the team didn't hire anybody with health insurance experience because they thought it would poison their thinking on how to innovate in the marketplace.

Renegotiating provider contracts. There is a set of optimal contracts. We used to have this at Cigna and Aetna, what we call PADU—preferred, acceptable, discouraged, and unacceptable. And so the team here now has an optimal view of what the terms and rates of the contract should be in support of an affordable product. Now we're taking every contract and measuring against that and renegotiating them. That's a huge opportunity to move down health care cost increases for the company.

As small companies, when you go into a market, nobody knows you and you're not going to get great rates. Now that we have a presence in these markets, now that we have a name in the marketplace, we can go back and reevaluate those.

There were a number of other really simple things about how to run the business more effectively. I thought I was going into an organization where there was low-hanging fruit, and there's actually watermelons rolling around on the floor. We're picking those up and moving forward to make the company more efficient. That's the benefit of health care expertise.

What I think happened in some of the other companies is, they had people with deep health care expertise, but they didn't work in organizations that had very sparse and narrow organizational reserve when it came to pricing in the marketplace. So if you come from a company like Aetna and you start up a small company, the executives running Aetna could never figure out how to run a small company. We didn't get involved at that level. The kind of people you need are (A) people who are learning and creating a common heuristic, a mental model about how the business works; and (B) somebody who has the patience to bring people along on what we've seen a million times.

I've made mistakes in all those areas more times than I care to admit. And having learned those lessons, I have an opportunity to teach and impart that to the team. So we have a whole new management process, a whole new planning process that's focused on creating a common mental model about what good really is so that we know how to run the business more effectively. And I think that hasn't been done in some of the companies that have failed.

Wade: You talked about the partnership with providers. In many areas, we're seeing generational change. We're seeing newer doctors coming in, not wanting to follow the same business model that their parents or grandparents had. They want a more predictable life and are looking, for lack of a better way to describe it, for shift work. So how are you seeing that play out in the conversations you're having with the providers?

Bertolini: Interestingly, number one, providers pre-pandemic were afraid of virtual health care—they said it couldn't be done. Once we got into the pan-

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demic, they realized, wow, it can be done. Secondly, and probably as importantly, they thought we were a competitor. Oscar Medical Group is a large virtual primary care group, and they thought it was a competitor. We view these virtual networks as an opportunity to create patient-centered medical homes around high-performing medical groups.

Let me make a point here that I think is really important as we look at these provider contracts. I don't think value-based contracts work. And I'm challenging the team here because we report every quarter, and we've got 50% of our contracts on members under value-based contracts.

If value-based contracts were the real driving factor, then most or all the physicians will be successful under those contracts. They're not. That's number one. Number two, when Mark Bertolini walks into a physician's office, that physician isn't saying, "let's see, Mark's an Oscar member, and we've got this value-based contract with Mark in this marketplace. I'm going to change my medical practice to be able to make that value-based contract work for me and on Mark." It doesn't happen. I would argue that really good cost-effective medical practices practice better medicine. And they use a constellation of specialists and other providers that works for them and practices the same way they do.

The hubris of insurance companies has been, "I'm going to sign you up as a primary care doctor. You're going to use my specialty network and my hospital network." You blow up all those connections, that constellation. So we now have a technology that was built in the early days of Oscar that looks at constellations of providers as effective and high-performing groups. And instead of breaking them up and having the hubris to believe that we know what the right network model is, let's contract with that constellation, and let's wrap our virtual care capabilities around it in a patient-centered medical home as part of the compensation that we provide to that medical group in order to get things right.

Instead of having every medical group in America, as you've seen with Iora and all these other groups, build their own patient-centered medical networks. We'll never be able to have all of that in every physician group in the country. So let's build that, wrap it around high-performing groups and contract with those groups as our preferred provider. And I would argue that we could waive co-pays and deductibles because they practice better medicine—we could pay them fee for service and we would be just as well off.

Audience Question: Back to the ACA subsidy question, because those need to be renewed and they probably will not be. I can only speak for some of the states that Anthem does business in, but in those states, most of the people who are on the exchange are almost fully subsidized. If the subsidies go away—even if it's for the higher income, I think it's going to probably go down substantially—do you think we're going to be back to an uninsured population? Or do you think those people will realize the value and stay in the individual market and be able to?

Bertolini: I don't think the subsidies will fall off below 300% of the federal poverty level. I think it'll just be above 300%. Which is still going to be a population that's impacted, right?

We're going to have a tough decision. It will increase the uninsured if those people

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can't get work and get coverage at work. And so our intent is to be very vocal about what could possibly happen. I think the intersection of a recession, which is a very stark reality, will cause people to think twice about taking that subsidy away, I would hope. But yeah, we don't want more uninsured. We want everybody insured.

The more flexible the marketplace is, where people can move around inside that market, among various situations—unemployed, employed, ACA— letting them keep their coverage would be a huge advantage. Coupled with the subsidies, I think that would make it a much more effective market. So we're going to push it. I don't know who's going to be listening in Washington, but we'll give it a shot.

Audience Question: One of the big disruptors in health care now are the GLP-1 drugs—the weight loss drugs that have great promise to really help people who need to lose weight or who have related conditions like diabetes. But they're extremely high cost. Is there a way to deliver that but manage the cost in the system?

Bertolini: First of all, when we get more of those drugs out, I think the costs will come down because it will be competitive. But we've got to get to that point sooner rather than later. I'm going to give a contrarian opinion on GLP-1s. It's not a popular one. I think the GLP-1s give people a magic bullet to reduce weight without having to make the kind of lifestyle changes that are effective in causing that weight to come down. I remember my mother telling me after I pointed to her and said, "no, that's your second piece of pie" after dinner. She goes, "I'll just take two pills before I go to bed tonight." That's the wrong approach.

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With gastric banding and everything else that we did for grossly obese people, at Aetna you had to go through an education process to do lifestyle change accompanied with your therapy. That's not happening with GLP-1s. I worry about that. Unless we educate people about maintaining a healthy weight—instead of having a magic pill that makes your problem go away—I don't think we're solving much of our problem. We're just pushing it down to another area. That's how I feel about where we are now. It's the glamorous thing to get. Everybody's talking about GLP-1s as a cool thing to take. I just don't think that's the right way to think about it.

For brittle diabetics and people with blood sugar problems, I think this is really important. Because it can stopgap some of the things going on. But I think its extension into other lines or other types of people is dangerous. The only way it's going to come down is when there's more than one or two of them. And if there's one thing we can trust the drug companies on, it's that they'll develop more of those drugs.

Audience Question: Can you talk about the role of pharmacy benefit managers (PBMs) and how you see it changing in the next few years?

Bertolini: I was at New York Life when we took Express Scripts public as the first publicly traded PBM. And we thought we had some magic in the way you could play with buy, sell, spread. You could play with the maximum allowable cost (MAC) list on generics. You could do rebate formularies. To some degree, I used to liken it to playing five card monte on a street corner in New York, trying to figure out where the queen was.

I think Paul Markovich at Blue Cross Blue Shield of California has done a brilliant thing. He's deconstructed the model and contracted with people in each piece of that model to get to the best price point. Now, it's going to be tough to coordinate. It's a big lift. But it's the beginning of the destruction of the PBM model.

We see, in more cases than not, when people are paying more for their drug in a co-pay than the drug costs, it's because of the PBM relationship. It just doesn't work anymore. And it's time we take that apart.

I don't think PBMs should be a profit model. I think they should be a focus factory that helps drive down costs for the overall health care center, particularly given that we're at 20% these days on specialty and prescribed pharmaceuticals. I think the PBM model has to change. And I think what we're seeing out of Blue Cross Blue Shield of California is the beginning of that change.

Wade: One last question. Even before the pandemic, though there became more of a focus on this during and post-Covid, we already had a mental health crisis before people were trapped in their homes and couldn't interact. There's a challenge in the supply of mental health professionals in the marketplace. How are you at Oscar thinking about mental health services?

Bertolini: We spend a lot of time thinking about it. We've spent a lot of time looking for the right provider solution. We don't think we have one yet, from the standpoint of taking care of our members. I think what we overlook in this country, and what we improperly treat, is anxiety. Anxiety is a deeply endemic problem across America. We don't teach people how to deal with it effectively, and we often misdiagnose it as depression and put people on selective serotonin reuptake inhibitors (SSRIs), which do not help with anxiety.

At Aetna, I was so focused on this issue, we were actually involved in the Domenici-Enzi-Kennedy-Dodd bill that got turned into TARP—which was the only way we got mental health parity passed, by the way, because TARP came along.

Proper diagnosis of depression is incredibly important, and so is proper education of the patient on the impacts

PROVIDERS PRE-PANDEMIC WERE AFRAID OF VIRTUAL HEALTH CARE—THEY SAID IT COULDN'T BE DONE. ONCE WE GOT INTO THE PANDEMIC, THEY REALIZED, WOW, IT CAN BE DONE.

and opportunities around SSRIs. And that often doesn't happen. The number one prescribers of antidepressants are primary care providers. We put together an education program online that helped them understand proper diagnosis and informing the patient that it's not going to work after you take your first two pills; it needs two weeks. And if there's any sexual dysfunction with it, there are other drugs we can use. Don't stop taking it. We offered to pay doctors $15 more per office visit to do that kind of evaluation and to take online education and take a quick quiz, then pass it. To every physician and every primary care physician in America.

We had 1% uptake on it—1%. To increase their reimbursement by about 30%. And so this challenge of properly diagnosing and treating is an incredible problem. Also, the proper treatment of anxiety—which is solely one thing, the fear of uncertainty and how to deal with it—doesn't necessarily require a clinician. It requires a therapist who can take people through that process. And so our system in the mental health area is understaffed, particularly Connecticut, right? And adolescent psychiatry is completely understaffed because it's overwhelmed with stuff that could otherwise be handled in different ways.

I'm actually working with a company now called Healing Track out of California, which cured me of my 18 years of chronic pain, by launching a program where we train and bring along coaches who can help people through these issues that are often misdiagnosed or overtreated. But it is a problem, and we don't have the solution yet here at Oscar. ✭

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Crises & Opportunities

Prudential's Rob Falzon shares his views on the resilience of the life and annuity industry, how technology is changing the industry, the retirement crisis facing our country, and more.

I first met Rob Falzon when he was the Executive Vice President and Chief Financial Officer for Prudential Financial and I was the Connecticut Insurance Commissioner. Prudential had a domestic in the state of Connecticut, and I spent a lot of time with Rob and the Prudential management team in supervisory colleges when the company was designated a Systemically Important Financial Institution (SIFI) under Dodd-Frank. In fact, we were in a supervisory college when the designation was rescinded. Rob Falzon is now the Vice Chairman of Prudential, where he is responsible for a broad portfolio within the company—investments, actuarial, IT, communications, and social responsibilities. He was kind enough to speak with me at our October 2023 Annual Meeting; what follows is an edited transcript of our conversation.—Katie Wade

Wade: Rob, you've been in the life and annuity business and at Prudential for a long time. Looking back, what do you think are the key markers for the industry?

Falzon: Probably the most significant thing has been the resiliency of the industry. I think about when I started my career, those were the Volcker times. We're kind of at that time again, where the Fed's fighting inflation. I remember I had a student loan at 16% and thought that was a good rate.

Think about the various crises or challenges that we've faced since then. That was the late seventies, early eighties. Then you had Black Monday in 1987, and we had the dot-com crash, 9/11, and the great financial crisis. And we've had the global Covid-19 pandemic. Throughout all that, the industry has actually been quite resilient. I know there have been problems scattered throughout the industry, but people need to put these events into perspective.

When we were designated a SIFI after the financial crisis, I was down on the Hill, and I used to cite these statistics comparing insurance to banking. I don't remember them exactly, but we have had a handful of insolvencies we've had to deal with on a yearly basis. There are hundreds on a yearly basis that the banking industry has to deal with. The quantum of problems that arise on the banking side compared to the resiliency on the insurance side—it's stark in comparison.

So we're doing something right. And I think that's worth reminding ourselves of, because as we're thinking about regulation going forward, it's worth keeping in mind what's worked. When things have gone badly, why did they go badly? There are

some themes there, and I'm happy to talk about those. But what's worked well and what do we need to preserve? That's one thing to keep in mind.

I'll mention a couple of other things. First, looking back and looking forward from a market standpoint, over the last couple decades, we've gotten very used to this "low for longer" environment. Well, now we're in a "high for the horizon" kind of environment. I don't know if anyone's quite coined that yet. But that's sort of our view of the world—it's structurally changed. We're going to have a very different interest rate environment than we've experienced over the last couple decades.

Higher interest rates are generally good for the industry, but as I like to remind people, the path to getting there sometimes can be painful. And we've experienced some of that. Associated with interest rates, or markets in any event, has been the volatility in the markets. There was the great moderation, and that's in the rearview mirror. We're experiencing much higher volatility today, and we're likely to experience more on a go-forward basis. That's generated by a lot of different things.

Another thing I think is really quite important is the rise of private credit. We've seen enormous growth within that sector. It's a $1.5 trillion marketplace today, up from $100 billion about a decade ago or so. There are a few reasons for that, and it's an interesting topic to dive a little deeper into. But it's very meaningful from an insurance company standpoint in terms of portfolio construction.

The last piece I would note, as far as the market is concerned, is the convergence that's been occurring between asset management and insurance—the catalysts behind that and the implications on a go-forward basis.

The other two things that are worth noting are, first, whether you call it the segmentation or specialization that's occurred within the industry over a period of time. Prudential used to be more of a generalist. We had health care, we had property and casualty. We had broad lines. Now we're a life insurance, asset management, and retirement company. And that's happened across the industry. Distribution used to be largely captive, but now it's largely independent both through agencies and advisors. And second, the introduction of technology and how that's changing the market.

The last topic I'd focus on would be the persistency of gaps in coverage, both from a life standpoint and from a retirement standpoint. I'm sure everyone here is familiar with the numbers—on the life side, there's a $12 trillion gap in coverage; 40% of individuals are either underinsured or uninsured. On the retirement side, it's a $30 trillion gap. I think the IMF or someone put out a number, they think within 5 to 10 years, that will be $135 trillion.

It's literally a crisis that's occurring within our country today. And so you have an issue where about 50% of the population does not have any retirement savings whatsoever. A large portion of our population is heading into retirement. You've got that gap that we haven't been able to solve historically. That's a challenge to the industry on both the insurance side and the retirement side: How are we going to address those gaps in a more meaningful way? It's going to require a lot of collaboration between legislators, regulators, and insurance companies.

Those would be the big picture things I'm very focused on, and I'm happy to talk about any of them.

Wade: Can you talk a little about the types of products that are being offered in the market? You mentioned how asset management and insurance products come together. We in the guaranty community deal with the end of a company, but we need to stay abreast of market changes as we go forward.

Falzon: There are some pretty dramatic shifts going on—some driven by capital markets, some by demographics. I think what you're seeing across product lines is more and more companies getting into what I'll call more "capital-light," fee-based type businesses. We're seeing this especially in the retirement space.

Part of that is being driven by the demographics; we have an aging society, and it's a society that's going to increasingly be thinking about what retirement and decumulation solutions look like. That plays to asset management and the annuities and retirement space. So you see a lot more in the way of product development—a lot of companies entering that segment, and that segment becoming a larger and larger proportion of the book and the sales of companies on a go-forward basis. But what you're also seeing is that there's been a trend toward—we like to call it de-risking, but you could essentially say it's sort of more capital-light, less-guaranteed products.

We've gone from a marketplace that used to provide consumers with a guaranteed outcome to a marketplace that's providing protected outcomes. And there's good and bad that comes with that. The good, from a company standpoint, is obviously that we're taking less of that burden onto ourselves. The negative from a consumer standpoint is that more of that risk is being borne by the consumer on a go-forward basis. The combination of markets and regulatory regimes, from a reserving capital standpoint, is pushing the industry further and further in this direction. Those would be the big drivers I see out there, Katie.

> **What you're seeing across product lines is more and more companies getting into what I'll call more "capital-light," fee-based type businesses.**

Wade: We've seen that people have not planned for retirement. We need to get the younger generation to start planning, because the systems that were in place for the older generation don't exist anymore. How do you see technology transforming the industry and helping people in this regard?

Falzon: Technology's one component of it, but I think there are going to be multiple solutions if we're really going to try to tackle retirement. Technology plays a role not just in retirement, but across the spectrum.

On the distribution side, if you're talking about the under-insured, uninsured, or the "under-saved for retirement," part of that is accessing that community, and technology can help us with that. What we're finding is that these products are generally sold—they're not bought. And I don't mean that in a pejorative sense. These are products where you have got to get from the front door to the kitchen table. It requires an education process. It's a topic that most people don't want to talk about, or they just put it off till tomorrow.

So you need to think about, how can we use technology to get deeper into the socioeconomic demographic where it's completely inefficient to have a high-commissioned sales force calling on that segment of the population, given the size of the policies that they're going to be insured with? How do you get people engaged in the conversation?

What we're seeing for the first time this year, in a survey of consumers, is that they have a higher preference for digital engagement on insurance products relative to direct engagement. That doesn't mean they want to buy digitally. It does mean that they want to be educated and sold digitally. But what we are finding is that the actual sale still requires an in-person engagement to make that happen.

So distribution technology can do a lot. We're thinking about putting in place hybrid models, where it's a digitally assisted agency. We're also using technology to capitalize on moments in people's lives and affiliations and associations—how can we find the right moment and the right channels to get expanded access to hit at some of those gaps?

Technology also is going to be important to the affordability of products. This is an issue that I think the industry is still struggling with. There were things that were put into place during the Covid-19 pandemic—no longer requiring wet signatures and changes to document delivery and other things—that still haven't been made permanent. And that's a challenge, because obviously they worked.

As an industry, we need to provide more affordable products. A big component of doing that is the cost of capital. You've got the yields you're getting off your portfolio, and you have your unit cost from an administration standpoint. We've got to bring unit costs down. We're the only industry I know of where if you go back a decade or two, our operating costs as an industry have gone up 20% over that period of time. Every other industry has gone down 10% to 40%.

Why? Part of it is that we haven't fully adopted technology. We still have the same distribution systems we had 20 years ago, so we're less competitive from a delivery standpoint than we were two decades ago. Given everything that's happened in technology and artificial intelligence today, we have to find a way to be more efficient.

Wade: Are you thinking of technology in terms of building it on your own, or is it more about partnering with companies to make products and information more accessible?

Falzon: All of the above. For instance, in our Group Insurance business, we entered into multiple ventures with insurtech or fintech companies in the last year. Most of it is centered on help with enrollment. You've got to get people to be more sophisticated consumers of the policies that are out there.

We have three ventures around assistance with enrollment. We've got another two that are around the claims side of it as well. It can help lower our costs from a processing standpoint, but also help with engagement with the clients on the front end. That's where we can joint venture with companies that are developing technology that's sort of boutique-ish but can nonetheless plug in to what we're doing. We don't have to own it. We don't have to invent it. We can partner.

But we also are developing our own technology. We're using artificial intelligence. We started with using it in the underwriting process to replicate what an underwriter would do. Now we're using generative AI to predict mortality in a much more specific way than even an underwriter can. So there are lots of opportunities for technology to help solve some of those challenges and close the gaps in front of us.

Wade: In terms of your company's social responsibility and making people more aware of the industry and how it can make a difference, I know you guys are doing a lot in Newark itself.

Falzon: In the past year or so, we hit three $1 billion marks. We invested a billion dollars in Newark. Part of that investment included the headquarters for PGIM, our global investment management business. But it was an investment in Newark. We gave away our billionth dollar from our foundation. And we invested our billionth dollar from an impact portfolio we set up.

I think the insurance industry lends itself to social responsibility. Probably every company that's represented here in the room feels that way. Prudential was founded on the basis of providing death protection to blue collar workers, which back in America in that day [the 1870s] was generally not available. In insurance back

We've gone from a marketplace that used to provide consumers with a guaranteed outcome to a marketplace that's providing protected outcomes. And there's good and bad that comes with that.

then, there was this belief that if you gave it to the masses, they would go around killing each other to collect on insurance.

Obviously, that was an "urban myth." But nonetheless, there were problems getting that population insured. And that sort of carried through the culture of our company. We have a 50-person group—what we call our inclusive solutions group—that's focused on community engagement both within the company and external to the company, in all the communities in which we operate. Whether we're in Japan or Brazil or Bermuda or the United States, we're trying to ensure that through that kind of activity and investing, we're furthering the social responsibility purpose of our company.

Wade: Switching gears a bit, concerns have been raised about pension risk transfers. Can you talk to us about your perspective on that market as well as what you think NOLHGA can be doing in that space?

Falzon: Actually, let me use that to launch into a slightly broader topic, and I'll answer that as well. Pension risk transfer, in the United States alone, is a $3 trillion opportunity. A study done by MetLife, I think, said that 90% of that will actually make its way from corporate balance sheets onto insurance balance sheets over time. If you take the equity market capitalization of every public company in the life and retirement sector today, there's not enough capital there to finance that transition.

The reason I mention that is, one of the trends I mentioned earlier is this convergence of asset management and insurance. One of the manifestations of that is alternative forms of capital coming into the insurance sector. That needs to happen, because that's just one gap. That's just one product line, one business opportunity that's out there for the insurance industry today. And it [pension risk transfers] would consume all the balance sheets of every public company. Now, I know there's public and private companies, but that's a big proportion of the industry's capitalization. It would consume 100% of it.

Now we're using generative AI to predict mortality in a much more specific way than even an underwriter can.

We need to find alternative sources of capital. And I think that's actually one of the benefits that's come from this convergence—institutional sources of capital are looking at the insurance industry as an opportunity for an uncorrelated risk investment, an alternative type of investment. And they have the ability to look at the underlying economics of some of the things we're doing, as opposed to the GAAP-posted results. Particularly for a public company, that can be quite challenging from time to time.

It's a huge market opportunity, just here in the United States—not to mention what's happening abroad, particularly in the UK, but most recently the Dutch market as a result of some pension reform that just occurred there. And I think the industry should welcome the capital that's coming in to close not just that gap, but the gaps we have across life and retirement.

As we think about that opportunity, insurance companies are incredibly well positioned to underwrite and manage that risk. It's on corporate balance sheets, but most corporations don't know how to really manage it. That kind of manifests itself in how they've been managed and why they've been problematic. Not to mention that it can get outsized in terms of the time and attention that it takes.

In the modern era of pension risk transfers, the first large transaction was the General Motors transaction that we did. And the CFO of GM said to me, "the way the market views us is not as a car company. They view us as a pension company with a car company attached to it." That issue dominated every earnings call and all the questions in the Q&A that they would get. They sort of needed to get the attention off that: move that off their balance sheet so they could focus on manufacturing and being a car company.

From an insurance standpoint, it's a great liability to have on our books. When I'm talking to investors about it, I say, "it's longevity. We know how to underwrite that—it's just the other side of mortality." So it's something we feel really good about. It's a great portfolio diversifier. Most of us are very long on mortality, so bringing longevity on is a good diversifier.

Also, what's been done to date has largely been relatively shorter duration

NOLHGA Conversations

books, because they're all retired individuals. That's going to change going forward—you'll see more and more people who haven't retired be part of these plans that are going to make their way into the marketplace. That will extend the duration. But to date, very little of the liability is outside of the investable universe. We can essentially immunize the liability out to 30 years, and you've taken care of all but a very small portion of the tail.

What you're left with is credit risk. And that's something we think we're really good at. About 95% of an insurance company's balance sheet is generally in fixed income. We know how to do credit, so it's a great liability for an insurance company to manage because it fits well with the liabilities we already have, the skills we have, and the investment management capabilities we have. In contrast, those things really aren't managed on a corporate balance sheet.

That doesn't even get into the robustness of the solvency regime in insurance. I know that you guys have been advocating for this. So thank you NOLHGA for doing that.

When you think about the skills that are there, the solvency, and the outcome for pensioners, this is a liability that ought to be managed within our industry.

Wade: You've touched a couple of times on the protection gaps. Can you expand on that and talk about your thinking around filling them? It's top of mind to regulators, legislators, and others, obviously, as well as companies.

Falzon: On the retirement side, this is a crisis for our country. It creates an opportunity for the industry, but the industry is not going to solve it on its own. The government can't afford to solve it on its own. And the regulators are going to have to partner with industry to ensure regulatory constructs enable us to address this.

As I said, it's a $30 trillion gap that will grow to a $135 trillion gap. Here's the basic problem. If you go back to 1970s or 1980s, about 80% of the private workforce would have been covered by a defined benefit plan. Today, that number is 15%.

Now there's a whole generation—basically the leading edge of the Baby Boomers—that is retiring. Many of them are retiring with defined benefit plans, but many got moved from defined benefit to defined contribution. They got 401(k) plans. The big issue they faced is, the companies basically said, "we'll create the environment for you to be able to save and provide for your own protection in retirement."

On the retirement side, this is a crisis for our country. It creates an opportunity for the industry, but the industry is not going to solve it on its own.

But there was no education. There were no constructs that encouraged people to exhibit good behavior. By way of example, everything was opt-in instead of opt-out. People typically don't opt in. They default—wherever you default to, there's a persistency in staying with that. And so what we find is that half of Americans have no savings.

The 401(k) gap is huge. And Social Security is not a solution. The average Social Security paycheck only covers 40% of the average household expenses. So you've got a 60% gap in the standard of living that's going to occur for the average American going into retirement—who's got no retirement savings because they went in with the idea that, "I'm supposed to save something; I never really did get around to it because I wasn't defaulted into a program. And incidentally, I didn't know how much to save."

In a defined benefit plan, I don't need to think about how much money I need to translate into an income stream that's going to last for the rest of my life. In a 401(k) plan, it's like, "do I need $100,000? Do I need half a million dollars? Do I need $5 million? What do I need in assets to generate an income stream that's going to last as long as I'm going to live?" They haven't a clue how to do that math.

It's a failure of our society to figure out how to help people manage their way into retirement. So we have to address that from all sides, and a growing area of interest for the industry going forward, as I mentioned earlier, is going to be around retirement solutions or decumulation solutions that you can embed into 401(k) plans and other retirement plans and say, "this is what you need in assets for us to provide you a guaranteed level of income that can supplement your Social Security, to get you to a standard of living you can be comfortable with on a go-forward basis."

That's going to be a critical piece. The SECURE Acts are helping to close some of those gaps—allowing annuities as a part of a 401(k) plan; beginning to move from an opt-in to an opt-out model. But how do you set up plans for people who aren't employed and don't even have access to 401(k) plans? How do you create options for people to enroll in 401(k) plans that are outside of their specific workplace? All those things need to occur. I think it's an enormous opportunity for the industry. It's a societal good and a societal need on a go-forward basis.

So that's the retirement gap. I think that's the most compelling thing in front of us. The insurance gap has been around for a long time. We haven't figured it out. If I had to point to a couple of things, one, we've got to lower our unit costs to provide more affordable products. Two, we need to think differently about distribution. As an industry, we are becoming increasingly concentrated—not more diversified, but increasingly concentrated in agency and advisor distribution. Which is great, except that it's an expensive form of distribution that can't get down to the socioeconomic demographic that can't afford to pay the kind of commissions that are going to make sense for those two things to marry. So you need to rethink distribution.

Cost of capital. Again, one of the benefits of this convergence between asset management and insurance has been a broadening of the investments we can use to enhance the yield of the portfolio. The better the yield, the more competitive we can be from a pricing standpoint. We need to lower our cost of capital by sourcing alternative forms of capital. Public markets for public companies are quite expensive sources of capital. You have companies that are trading out there at four times earnings. That's an incredibly high cost of capital. You have to find alternative forms of capital to be able to lower the cost of the end product.

And then regulation. This is my point about wet signatures and hard delivery and accelerated underwriting and intelligent underwriting—there need to be guardrails around all of that, but if we don't adopt some of those things, we'll never be able to drive the costs down and increase the accessibility.

Audience Question: What do you think about the current economic environment and how it could impact the industry going forward?

Falzon: From an economic standpoint, we're actually quite optimistic about what the economy is going to do, beyond even a soft landing. Our view is that we're probably not going to have a recession at all, never mind a mild recession. But one of the reasons you're having higher rates on a sustained basis is that there's higher geopolitical risk, including at home.

That risk has two manifestations. On an international basis, that geopolitical risk leads to de-globalization—supply chain risks and whatever labels they want to put on to it. But it's protectionism, and it's bringing manufacturing and supply chains back in, which increases the cost of production. And that's less efficient. That's leading to higher inflation and higher interest rates.

But then also there's a higher risk premium in the bond market today. A higher risk premium on Treasuries and a higher risk premium on global rates as well. So that factors into our economic prosperity on a go-forward basis.

Given my own experience during different interest rate cycles, it feels very painful where we are today, with mortgages being at 8%, but I remember a time when a mortgage at 7% or 8% was the greatest thing since sliced bread. Everything's relative, right? That transition from a 3% mortgage to an 8% mortgage is painful, but we'll adjust as an economy.

I think housing will begin to pick back up, and trades will begin to occur, and construction will start, and people will buy homes and recognize that 8% mortgages probably mean there's some adjustment in pricing that will occur within the marketplace. But we don't think that holds the economy back from moving forward. We're actually pretty upbeat about the economic outlook, but with that economic outlook comes this higher rate environment.

Audience Question: Prudential is an international company. What have you learned from all your international operations?

Falzon: About 45% of our earnings are from outside the United States, but a lot of that is concentrated in a single country—we have a huge operation in Japan. We're not exposed to Europe. Our footprint right now is the United States, Japan, Latin America, and then a select number of Asian markets: China, India, and Indonesia being primary amongst those. So when we think about the regulatory agenda and our products and financing the company, we do think about it with an international lens, a global lens. I spend a lot of my time on the international side, the international regulatory agenda. There's some intersection of that on the U.S. side. But obviously, we're taking a very different route than where the Europeans are going.

I'll use Japan as an example, because I'm very familiar with it. Japan as a country is highly dependent on trade. And so they have a history as a culture and as a society of supporting international constructs because it keeps their doors open in and out. So as the IAIS develops international standards for the insurance sector, we are seeing the standards influence insurance regulation in Japan. The Insurance Capital Standard (ICS) is an example where Japan is embracing it but the United States is not, given concerns it has with the framework.

Given the influence the international landscape can have at the jurisdictional level, we have to continue to engage in what's happening globally. We can't ignore it. The same applies for jurisdictional regulators

Audience Question: I think private equity comprises 15% of the life insurance market now. Can you talk about the implications of the entrance of private equity in the insurance market?

Falzon: About 15% is a good number. It's about $60 billion of capitalization in private equity companies right now in insurance. To put that in perspective, I was giving a talk on this at a different forum, and I said, "if you exclude the 4 largest public companies—ourselves and three others—and you take the next 8 companies, numbers 5 through 12, and aggregate up the capitalization of all those companies, it's smaller than the private equity players are in the industry today." That's how fast it's grown.

Our view on it is that a lot of good has come from it. The two principal things I would point to, which I mentioned earlier, are one, it's brought a source of capital into the industry that I think the industry badly needs. There are mutual companies, and you have policyholder capital; there are public companies, and you have public capital. But the industry needs private capital as well to be able to address all the gaps that are out there—to facilitate the transition of pensions from the corporate sector to the insurance sector.

In addition to the quantum of capital that's needed, we need diversified sources of capital that have a whole range of risk-return appetites associated with them. So we can get deeper into the socioeconomic demographic with lower-cost capital than what our blended cost of capital might be as a public company. And we can also solve for the needs of the more sophisticated end of the market, with guaranteed products that don't work well in the public market because they're too complex and the accounting is unfriendly. So having a group of investors that look at underlying economics that have a range of risk-return appetites, I think, is actually quite helpful to the industry. That's one.

The second benefit to the industry has been an expansion of investment capabilities. Now, we need to look harder and deeper at the investments that are being made to make sure we fully understand the risks. Where we've had insolvencies in the past, particularly the larger ones, it's always two things, right? It's asset/liability management, or the lack of asset management, I would say. And portfolio credit and diversification. Over-concentrated in high yield, over-concentrated in real estate, over-concentrated in subprime. From an asset/liability management standpoint, having those type of investments matched up with near-term maturities or risks of acceleration of your book, surrenders in your book.

When you're thinking about the alternative investments that have been introduced into the industry, a lot of it has been in structured product. Speaking just from our perspective on that, we're big buyers of structured product in the public markets. We've been a little bit more cautious in the private markets. I think having a broader array of private instruments for the illiquid appetite that you've got within your portfolio is good. Remember, the industry on average is 35% or so allocated in illiquids. The rest of it is in publicly traded stuff. So within that basket that you have for illiquids, having more options is a positive.

In our own book, we're highly concentrated in commercial mortgages and in traditional private placements, and they've been great for us. But having a couple other things to look at—that could create greater alpha for us and also diversify—I think that's a good thing for the industry. We just need to make sure that we deeply understand those products as they're being introduced into the industry.

We're less hung up on the idea that it's private equity coming into the industry. I think the proper way to think about it is activities based, not sponsor based. Are you comfortable with the portfolios that are being constructed, the regulatory regimes in which this is being done, the reserving and the capital that sits in the portfolio that backs those, how the liabilities are being underwritten? Whether it's a private equity firm or a traditional insurance company doing that, I think that's much less important than making sure that the activities are well understood and appropriately reserved and regulated. ✯

["Higher Learning" continues from page 1]

PRTs in SLC

One of the bigger issues in the insurance industry is the growing pension risk transfer (PRT) market and what role private equity might play in it. With the Annual Meeting being held only three months after the Department of Labor's ERISA Advisory Council hearing to discuss possible revisions to Interpretive Bulletin 95-1 (IB 95-1), which outlines the factors companies need to consider when moving their pension plans to an insurer, a panel on the PRT market was a no-brainer.

Fortunately, the panelists packed plenty of brain power. Moderated by NOLHGA's Mike Heard, the panel featured Ian Cahill (Head of Pension Risk Transfer at MassMutual), Michael Clark (Managing Director with Agilis, which advises companies looking to move their pension plans), and Kevin Griffith (Partner at Faegre Drinker Biddle & Reath).

Clark gave attendees a sense of the dollars in play, noting that the market had grown from $1–$2 billion before 2012 to more than $50 billion in assets transferred to insurance companies in 2022. While that number dipped in 2023, he said, "everybody's thinking that starting in 2024, we're going to see that market ratchet up again, and $50+ billion is going to be the norm for the foreseeable future."

Companies are moving their pension plans for a number of reasons, Cahill said: "For a lot of plan sponsors, the risks inherent in the pension plan are not their standard business." Manufacturing companies, for instance, don't specialize in longevity and interest rate risks—but insurance companies do, which makes these transactions so attractive to the insurance industry. Companies are also looking to avoid escalating premiums paid to the Pension Benefits Guaranty Corporation (PBGC), and some just want to get out of the pension business because their pension experts are retiring. The bottom line, he added, is that "the plan sponsor has

NOLHGA Chairs Highlight Education in Annual Meeting Addresses

Outgoing NOLHGA Chair Nancy Davenport and Incoming Chair Gerrie Marks cited the importance of education, both internal and external, in their comments at the 2023 Annual Meeting. Davenport began her remarks by thanking the members for their input in the search for NOLHGA's new President—"the involvement of the members meant everything"—before pivoting to the need to provide education to newer members of the guaranty system. "Let's look at all the resources we have available and ask ourselves—is there a better way to present them to the members, to make them more accessible?"

Davenport pointed to the MPC's new mentorship program as a vital piece not just in education, but in welcoming new members into the guaranty community. "One of the great things about new people is that they bring new energy and new ideas," she said. "But if they don't feel welcome—if they don't feel confident in sharing those ideas—we all suffer." She also cited the work done by NOLHGA's Education Project, which played a role in NOLHGA's testimony before the ERISA Advisory Council in its hearing on pension risk transfer transactions, as well as the Receivership Tabletop Session conducted by NOLHGA and the NCIGF at the NAIC's Fall National Meeting in November 2023.

Gerrie Marks

Nancy Davenport

the opportunity to walk away, and they have settled their liability."

Many pension plan participants worry that a PRT transaction will strip them of protections spelled out in the Employee Retirement Income Security Act (ERISA), such as fiduciary committees that oversee the pension plans, spousal and creditor protections, and PBGC coverage if their pension plan goes bankrupt. Clark, however, stressed that IB 95-1 outlines many protections for plan participants by requiring that fiduciaries evaluate the assuming insurance carrier's ability to pay claims, consider the value of establishing a separate account to cover only the pension plan liabilities, and consider state guaranty association protection if the insurer ever becomes insolvent.

Looking at the PBGC versus guaranty association coverage issue, "we think both regimes provide ample protection to the majority of participants with those benefits," Clark said. "When we do some analysis of the state guaranty association coverages, plan sponsors can get really comfortable really quickly that the

In a moving luncheon speech that touched on the vital role insurance has played in the world economy and in his own family, Pulitzer Prize–winning journalist and author Ron Suskind praised insurance's ability to protect people from "things you would never imagine—the 'God forbids' of life." He also quoted from a letter his father wrote shortly before he passed away, urging Suskind and his brother to "do something worthwhile with your lives." He rereads it every year, he added, and "with each decade, the letter reads differently to me."

She concluded her remarks by praising the guaranty associations. "While we're working on these big projects, our member guaranty associations are doing the day-to-day insolvency work that keeps this system going," she said. "None of this works if we drop the ball on protecting policyholders."

Marks echoed Davenport's themes of education ("as we welcome new people to the system, we also need to reevaluate how we deliver education to them") and welcoming new members. "One of the main reasons this system works so well is because the people in it have learned to rely on each other and trust each other," she said. "That takes time, and the easier we can make that process, the better."

Marks noted that the theme of her speech was "the only constant in life is change," adding that "some of the changes I'm talking about are baked into what we do." New insolvencies always bring new challenges, and that was especially true in 2023. "We've seen single-state insolvencies in multiple states, and that's a model that doesn't quite fit in with how we've done things in the past," she explained. "If this is going to be the new normal, we should have a candid discussion about what we've learned so far."

Turnover is a constant challenge, both in the guaranty community ("succession planning needs to be a priority for every guaranty association") and in state insurance departments. New products and industry trends—private equity's role in the industry, the growth of the pension risk transfer market—also pose challenges, but Marks expressed confidence that the system would rise to the occasion, as it has done in the past: "We need to commit ourselves to understanding these challenges so we are equipped to continue our proud history of being there for policyholders when they turn to us."

majority of their participants are still going to be covered if something were to go wrong."

Griffith agreed. When an insurer assumes a pension plan and issues annuities to the plan participants, "it is no longer an ERISA plan, but it is still regulated by the state insurance regulatory system," he explained. Since the number of defined benefit plan failures in the last 10 years vastly exceeds the number of insurance company failures, he added, "I would argue that it is more highly regulated from a financial solvency standpoint than it was as a defined benefit plan. At the end of the day, it really does move people into a more solid, safe environment."

Cahill noted that in many large PRTs, companies structure the contract to include the separate account mentioned in IB 95-1. "In the event of insolvency, those assets would not be used to back liabilities outside of the separate account," he said. "That added protection is important to plan sponsors."

Turning to the concerns over private equity, Clark suggested that the worry stems from a misunderstanding—and perhaps from the popular image of private equity firms buying companies in other industries and stripping them of their assets. "These are more long-term 'buy and hold' strategies," he said of PRTs, adding that insurance companies—whether funded by private equity or not—are all regulated the same. Also, IB 95-1 already requires plan sponsors to do their due diligence on the insurer assuming the pension plan, which means deals involving private equity carry no more risk than deals with more traditional insurers.

IBTs, AI & More

PRTs aren't the only issue facing the guaranty system, and another Annual Meeting panel looked at a host of other issues with a focus on the frequent collaboration between NOLHGA and the ACLI's Receivership Committee. The panel consisted of moderator Jana Lee Pruitt (Executive Director of the Kentucky Life & Health Insurance Guaranty Association), who staffed the committee for 10 years during her time with the ACLI; Committee Chair Eric DuPont (Vice President & Counsel, Government Affairs, Guardian Life Insurance Company of America), who participated virtually; and Wayne Mehlman (Senior Counsel with the ACLI).

Utah Insurance Commissioner Jonathan Pike welcomed attendees to his home state and praised the guaranty associations for the work they do to protect policyholders.

Pruitt kicked off the conversation by noting that the Receivership Committee, which dates back decades (it was first called the Solvency Committee), originally focused on passing GA Act legislation in the states that did not have a life and health insurance guaranty association. While that focus on GA Act legislation remains, the committee now works on a wide variety of other issues, from insolvencies to insurance business transfer (IBT)/corporate division legislation to international issues. One thing that hasn't changed, she added, is the committee's collaboration with NOLHGA. "NOLHGA began within the ACLI, and the two organizations have always had a great, mutually beneficial relationship," Pruitt said.

DuPont also highlighted the importance of collaborating with NOLHGA. "The main role of the Receivership Committee is to develop and recommend ACLI policy on legislative and regulatory issues relating to receiverships, rehabilitations, liquidations, guaranty associations, and other insolvency-related issues," he said, which means NOLHGA, by necessity, plays a large role in the committee's work.

DuPont pointed to the 2017 revisions to the NAIC's GA Model Act, particularly the inclusion of HMOs as member insurers and

"I truly believe this is one of the most important elections that will take place, because we are starting from a fiscal deficit, so there are no easy choices—we can't just spend more on everything. That's usually when we start to make the tough decisions."

Juhi Dhawan

the 50/50 life/health insurer split on future long-term care insurance–related assessments, as a prime example of the committee's work. "It was a challenging time, driven by the urgency to find the right solution to make sure we were going forward with a strong and vibrant guaranty system," he said, "That helped to bring about camaraderie, even though some parties might have had different interests. The guaranty system is always being challenged, but it's always being improved as well."

Mehlman focused on another hot-button issue in the industry. "The ACLI has adopted principles and guidelines on IBT/corporate division legislation," he said. The committee spent months analyzing state laws and the Part VII transfer law in the UK before settling on five core principles—including independent expert review and guaranty association protection for policyholders. "There aren't many IBT/corporate division bills out there," he added, "but we have our principles, and we have something we can use to evaluate bills as they're introduced."

The committee has also worked on a variety of other issues, domestic and international. It has reviewed the International Association of Insurance Supervisors (IAIS) Core Principles as well as the Financial Stability Board's Key Attributes, and it also commented on the section of the Federal Insurance Office's annual report that touches on guaranty system issues. Closer to home, the committee was approached by the Pennsylvania Insurance Department to review legislative language that addresses the state Supreme Court's ruling on *Warrantech* in the Penn Treaty/ANIC liquidations. "That will be an interesting process as it works through the Pennsylvania legislature," DuPont said. "We know not all parties are aligned on how it should come out."

A good deal of the committee's work centers on the NAIC's GA Model Act. Working in concert with NOLHGA, the committee reviews and often contributes to revisions (as in 2017), but the work doesn't end when the NAIC adopts a new Model Act. The ACLI offers support to states that wish to incorporate the latest revisions in their state statute, from drafting bills to lobbying in support of their passage. Currently, 42 states have enacted the 2017 revisions to the GA Model Act, many with the help of the ACLI. "The support is there from the trades, but we always knew there'd be a day when we'd be down to a few states, which is the case now, and they'd be difficult," Pruitt said. "It's usually for political reasons—it's not for lack of support from the industry."

Moderator Jana Lee Pruitt (Executive Director of the Kentucky Life & Health Insurance Guaranty Association) and panelists Wayne Mehlman (Senior Counsel with the ACLI) and ACLI Receivership Committee Chair Eric DuPont (Vice President & Counsel, Government Affairs, Guardian Life Insurance Company of America), who participated virtually, reviewed the issues being addressed by the Receivership Committee and its long history of collaboration with NOLHGA.

Politics also made its way into the economic forecast by Juhi Dhawan (Senior Managing Director, Partner, and Macro Strategist with Wellington Management). In a wide-ranging discussion of the U.S. economy, Dhawan noted that "we are running fairly large deficits" that will have to be addressed by Washington. She added that the deficit will make its presence known in any number of different areas—in response to a question about the always-rising cost of health care, she predicted that the government, facing growing expenses from Medicare and Medicaid, will have to deal with the issue. But how? "I truly believe this is one of the most important elections that will take place, because we are starting from a fiscal deficit, so there are no easy choices—we can't just spend more on everything," she said. "That's usually when we start to make the tough decisions."

However, she also warned that those decisions might not be forthcoming, due to the situation in Washington. "It's difficult for me to see any path forward to make any changes" on things like the debt limit and other issues, she said. "This gridlock does have consequences."

Turning to the employment picture, Dhawan stated that "tight labor markets are here to stay," citing studies predicting that the number of workers—especially for lower-skilled jobs—will decline significantly in the next 10 years. However, the impact of this decline could be blunted somewhat by the increase in work from home situations.

While the work from home trend is playing havoc with commercial real estate, Dhawan noted the United States is seeing its highest rate of female workforce participation in several decades. "I've talked about a shortage of workers—that's how you ameliorate things, by making changes that allow more workers to be included in the workforce," she said. "The U.S. today has amongst the lowest prime worker participation rates in the developed world. We're much lower because of inflexible work practices that have held us back."

That said, working from home doesn't work for everyone—studies indicate that it really doesn't work when you need to train people, and companies have noticed. "We're seeing a greater stringency in companies insisting that hybrid means hybrid," Dhawan said, as companies insist that if you're sup-

Juhi Dhawan (Senior Managing Director, Partner, and Macro Strategist with Wellington Management) provided attendees with a fascinating look at the U.S. economy, touching on tight labor markets, the effect political gridlock can have on the economy, and the long-term impact of AI on various job sectors.

posed to come into work two or three days a week, you actually have to show up. "I think that requirement will go up."

Another thing that could—possibly—help with the labor shortage is artificial intelligence (AI). While many think of AI as a job destroyer ("the worker displacement question is now much more at the forefront of policy," Dhawan noted), AI is already showing signs that it can boost productivity in certain sectors and among certain groups of workers.

For instance, ""the service industry is very labor intensive, and productivity has been terrible," Dhawan said, "There's no other way to say it." Some companies have used AI to boost their productivity, but we're in the early days. "I think generative AI is another step forward in finding higher productivity, but it takes a long time for technologies to diffuse and for us to see the benefits across the economy."

What AI gives, AI can also take away, and Dhawan pointed to its potential to reduce jobs, or at least wages. Software engineering companies are reporting that they can model new products much faster than they used to, by using AI. That means less demand for the engineers who used to do all that modeling. AI, Dhawan explained, could result in lower wages at the high end of the labor market and higher wages at the low end.

However it shakes out, she said, one thing is certain—workers will be on the move. The average graduate today expects to change jobs at least seven times, and AI will not push that number down. "My expectation is that there will be a renewed focus on education and re-skilling and thinking about new jobs." ✪

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

To read more about NOLHGA's 2023 Annual Meeting, see "**The Future of Health Care**" on p. 4 and "**Crises & Opportunities**" on p. 14.

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