Volume XX, Number 1 | April 2014

nolhga journal

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

The Wait Is Over

After a long labor, FIO has given birth—here are the key takeaways

By Charles T. Richardson

We were approaching two years since the Federal Insurance Office's (FIO's) modernization report mandated by Title V of the Dodd-Frank Act of 2010 was supposed to come out, although we did see FIO's first annual report in June 2013.[1] But now we have the real live, super-duper, party pooper, no moogey/foogey FIO statutory insurance modernization improvement report! The birth came on December 12, 2013, after that long labor.[2] The federal baby was big. Really big.

The 70-page report is chock full of information and recommendations. It is divided into five parts:

1. An introduction with a summary of recommendations for modernizing insurance regulations in the United States.
2. The history of insurance regulation in the United States.
3. An analysis underlying the recommendations regarding prudential oversight.
4. An analysis supporting the recommendations concerning marketplace oversight.
5. Principles of regulatory reform as it affects insurance.

It will take a bit more digestion to figure out the push points, the pull points, the areas stimulating indigestion, and those that are helpful in the pathway to better consumer protection, insurance sector strength and vitality, and overall efficiency and logic in a $1.1 trillion in premium/$7.3 trillion in assets segment of the U.S. economy. But here are my initial takeaways.

Read the Summary!

The report is well written and supported, with much to consider. My suggestion is that every single person reading this article, plus your kids and grandkids, print three things and read them—really read them:

1. The press release accompanying the report.
2. The report's table of contents/glossary.
3. The summary on pages 1 to 10 of the report.

I guarantee that those summary pages are what every insurance staff member of Congress has read. They capture what FIO Director Michael McRaith is going to

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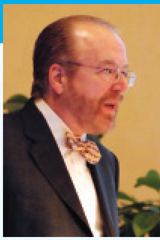

Rooster or Feather Duster?

The following was adapted from my President's Address, delivered on October 23, 2013, at NOLHGA's 30th Annual Meeting.

Bob Ewald, former Executive Director of the Illinois guaranty association and a "founding father" of the guaranty system, told me some years ago that he views the NOLHGA President's comments at the Annual Meeting—no matter what mope may then be delivering them—as being analogous to the U.S. President's annual report on the State of the Union: obviously not in pomp or splendor, but because this address serves as an occasion for an annual appraisal by all of us of where we stand and of our most significant current concerns.

In that regard, my chief observation is that the state of the life and health insurance guaranty system remains strong, but the challenges confronting us are different than they have ever been before. Those challenges—many of which have only crystallized in the past few months—are serious and will require our best efforts and our clearest thinking.

Before I give you my take on some of the points addressed yesterday by former NOLHGA Board Chair George Nichols and General Re's Damon Vocke, we should recall the big picture.

Given the multi-level, interrelated series of protections for consumers in the insurance field, insurer insolvencies are rare to begin with—even in periods of recession or depression—and when they do happen, in the vast majority of cases, insurance consumers have faced few (if any) reductions or losses of benefits.

By "multi-level protections" I mean this: Our industry is financially conservative to begin with—insurers are not what the market calls "high fliers." Long-term investments matched to long-term, stable, "sticky" liabilities; low leverage; no maturity transformation; and so forth. Second, we have very conservative—and generally quite effective—financial solvency regulation. Third, we have a soundly designed and generally effective receivership system in which consumers get fully protected before lower-ranking creditors or equity owners receive anything. And finally, we have a well-designed and effective guaranty mechanism.

In addition to the recently closed ELNY matter—where our members fully satisfied all of their obligations and the industry went above and beyond in responding to the mess we confronted—in *addition* to ELNY, our members continue to perform spectacularly, protecting virtually every penny of policyholder expectations in the Lincoln Memorial insolvency case. That's a case that, in its own way, was as difficult and challenging as ELNY. The Lincoln Memorial case gets almost no media attention, other than isolated stories about the criminal convictions of those who looted the company, but it's a huge success and strong evidence for the effectiveness of our system.

The same is true in a long line of insolvencies dating back to and before the 1999 "Thunor Trust" company failures caused by the looting and embezzlement schemes of Marty Frankel.

In all those cases and so many others, the regulators did their jobs; we did our job; and consumers were substantially protected. It should always work that way.

But enough history. It's great that we've done well for the first four decades of our history, but you know what former NOLHGA Chair Ron Downing used to say when something was going well: "Be careful, because you can be a rooster one day and a feather duster the next."

You might subtitle the balance of my remarks, "Things to consider in trying to avoid becoming a feather duster." I'd like to talk about the reports you heard from George Nichols and Damon Vocke yesterday. Those are two guys who, as far as I

know, had never met, spoken, or corresponded before we convened here, but who used very different language to deliver substantially the same report about a number of late-breaking national and international regulatory developments that are touching—and will continue to touch—our world.

No matter what else happens at the federal, international, or state levels, one thing we MUST do to avoid becoming feather dusters is continue to deliver effective, compelling, professional satisfaction of our responsibilities to covered consumers and to our membership in the insolvency cases coming before us. Nothing less than our best work and best efforts will suffice, in each and every case.

And if we show the outside world ANY reason to believe that the guaranty system is divided on significant resolution issues; or is not responding in an effective, precise, speedy, consistent, and nationally coordinated way, we'll be killing ourselves. We need unity, and we need coordinated effort if we want to have a future. That means that sometimes a member will need to ask seriously, "Do I have a truly compelling reason for rejecting a conclusion reached by the vast majority of my equally committed, equally thoughtful peers?" Put another way, for all our sakes, individually and collectively, this is a time for unity, and not for ego tripping.

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A good part of George's suggestions yesterday related to fundamental strategic planning. We need, more than ever before, to be looking over the horizon, so that we can identify developing material issues, and so that we can decide what to do about them.

So I'm going to play futurist for the next few minutes, bearing in mind one of my favorite Yogi Berra quotations, that prediction is hard—especially when it involves the future. And so I'll mention four topics of strategic significance:

The Developing Federal Interest

Both George and Damon talked about recent regulatory expansions on the part of federal and international bodies: not by legislation, but by regulatory mission creep that threatens to crowd out the work now being done by state regulators and, potentially, by the guaranty associations.

The FSOC has now determined that both AIG and Prudential are SIFIs, and it has published findings relating to each determination setting forth some bases for its conclusions.

A central thread in both rulings concerned the "resolvability" of the subject companies. Could they be resolved under existing laws and systems without posing an undue threat to the financial system? In both cases, the FSOC concluded—the second time over the objection of Roy Woodall, Commissioner Huff, and Ed DeMarco of the FHFA—that there were enough doubts about the resolvability of each company that the FSOC should designate each a SIFI, permitting substantial supervision by the Federal Reserve, the imposition of higher capital standards, living will requirements, and the use (if necessary) of the Dodd-Frank Title II "orderly liquidation authority."

The FSOC majority opinion expressed concern that troubles with either company could result in "runs on the bank," "contagion" to other insurers (prompting runs at their competitors too), fire sales of insurer assets that could unsettle the markets, and other negative consequences—even though no such consequences ever obtained for traditional insurers in the recent financial crisis, or, for that matter, even in the Great Depression.

For me, the most troubling aspect of the FSOC's findings on AIG and Prudential was the lack of any real limiting principle. Since the speculation about runs, fire sales, contagion, and the like was just that—speculation—without any evidence or analysis—historical, empirical, or otherwise—what would differentiate, *for the FSOC*, the characteristics of an AIG or Prudential from the tenth ranked life insurer? Or the 30th? Or the 50th?

Recall that when she was FDIC Chair, Sheila Bair was quoted as saying that she could easily envision there being a few dozen non-bank SIFIs, and if the lower boundaries drop a lot below the level of the three insurers that have been designated or targeted so far, shouldn't we even expect a number of other designations, including one or more of the major health insurers?

In any case, even without further insurer SIFI designations, the Federal Reserve is already exercising holding company regulatory powers over a couple of dozen insurer groups that have banks or thrifts in the corporate structure. The Fed has staffed up with senior people devoted to insurer regulatory issues. The Fed, as an insurance regulator, is here to stay. And if the industry comes to perceive a competitive advantage in

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Thirty-So

NOLHGA celebrates its 30th birthday in style at the 2013 Annual Meeting

By Sean M. McKenna

Throwing yourself a birthday party is always tricky, but NOLHGA was thrilled when almost 200 of our closest friends trekked down to Florida in October 2013 to help the association celebrate its 30th birthday. It probably didn't hurt that the party was at the beautiful Eau Palm Beach Resort & Spa, or that our guests got a chance to hear from an impressive array of speakers from the insurance industry and regulatory community.

Regardless of why they came, the important thing is that all the Annual Meeting attendees were surely glad they came, because NOLHGA's 30th Annual Meeting was one of our best yet.

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Regulation at Home & Abroad

The changing face of insurance regulation was one of the key themes of the 2013 Annual Meeting, with insights offered from regulators and industry members. Roy Woodall, Independent Member of the Financial Stability Oversight Council (FSOC), recalled how it was decided that the council needed insurance expertise ("I'm two sentences in the statute") and how crucial it was for the FSOC to spell out its criteria for designating systemically important financial institutions (SIFIs). "People were clamoring for some guidance," he explained, which is why the FSOC released a list of criteria for companies to consider.

Woodall discussed his reasons for dissenting from the council's designation of Prudential as a SIFI, explaining that he disagreed with its finding that the company's failure could do significant damage to the U.S. economy. He noted that council was concerned about a potential "fire sale" of assets if the company found itself in financial difficulty—"I don't know how many times I saw that phrase," he said—and that he felt the council made a mistake by not recommending any solutions to the potential problems it identified. For instance, the FSOC said the company's failure "could place a significant financial strain on the guaranty mechanism," Woodall said, but never offered any recommendations to strengthen the system and so reduce the danger of such a strain. "If it's a problem, what are you going to do to fix it?"

Dennis Johnson, President and CEO of United Heritage Financial Group

FSOC Independent Member Roy Woodall

Woodall added that he thought the Financial Stability Board (FSB) erred by releasing its list of "Global SIFIs," which included Prudential, five days before the FSOC held its hearing on Prudential's designation. "It bothered me to no end," he said. "It seemed like the SIFI process had been overtaken" by international considerations.

International considerations were very much on the mind of another speaker, former District of Columbia Insurance Commissioner William White, who flew in from a meeting of the International Association of Insurance Supervisors (IAIS) to speak at NOLHGA's Annual Meeting. White noted that the "interconnectedness of financial markets and its inherent risk is perhaps more fully realized" among regulators than ever before. And while that risk was previously linked with banks and securities firms, insurance has been added to the list.

The IAIS is still working on its ComFrame document for insurance regulatory standards, what White called "the linchpin for international regulation." He added that "there's been a debate in the IAIS about whether a global capital standard is necessary for insurance, but what the FSB told the IAIS in June is that the debate is over."

The standard, which the IAIS is developing, is due in 2016 and is scheduled to be implemented in 2019. "Given the amount of work that needs to be done," White said, "that's tomorrow." He stressed the importance of the industry and regulators working together to fashion this standard. "If we fail, the FSB could develop a model for us."

An industry perspective on regulatory change was provided by Damon Vocke, Executive Vice President, General Counsel, and Secretary for General Re Corp. Vocke began by praising state-based insurance regulation—"In my view, it's not broken," he said—but admitted that the trends seem headed toward increasing federal involvement, beginning with the Federal Insurance Office (FIO), which at the time had not released its long-awaited report on regulatory modernization. "There's a

Warnings & Encouragement from NOLHGA Chairs

Neither Outgoing NOLHGA Chair George Nichols III nor Incoming Chair Melody Jensen uttered the words "the Feds are coming" in their addresses at the 2013 Annual Meeting, but the sentiment ran through both their remarks.

After noting how happy he was that the ELNY receivership closed on his watch, Nichols went on to catalog some of the warning signs facing the guaranty system. Chief among these is the growing involvement of the federal government in insurance regulation. While the guaranty system and state-based regulation emerged relatively unscathed in the Dodd-Frank Act, recent events have shown that the federal government's involvement in regulation—and possibly receiverships—will be greater than expected. "I'd say we lost, not failed," Nichols said of the Act. "We did what we were supposed to do."

Nichols pointed to the danger of the FSOC's power to designate SIFIs (two insurance companies have already been designated, with a third under consideration). And he expressed skepticism that the Federal Reserve would consult with insurance regulators or the guaranty system if a SIFI were to fail. "The Federal Reserve doesn't have a desire to learn, because they [know banks and] don't think much of the people doing the talking—us," he said, adding that the FSOC and FSB had recently called into question the effectiveness of the guaranty system.

The challenge for the system, he added, is "to demonstrate the courage to do what's necessary" by creating a national guaranty system—and to do so before someone else does it for us. "I hope I scare the hell out of you about the threat to the system going forward," he said, adding that improving the system is so vital because "we do truly serve a noble cause."

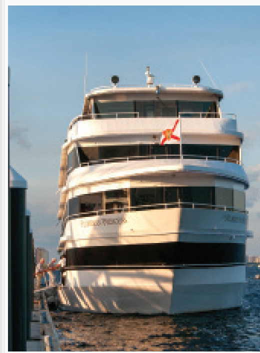
Jensen also noted the importance of the work done by the guaranty system, saying that "we're a small organization, but the work we perform—and the impact we have on policyholders—is anything but small."

She also commented on how NOLHGA's role has grown from offering only insolvency support to now working with Congress and others. "NOLHGA has become a trusted resource for information about the guaranty system, at least in part because everyone from the ACLI to the NAIC to Congress to the Department of the Treasury knows that when they call NOLHGA, they get answers—not a sales pitch," Jensen said.

That reputation as a "trusted advisor" will serve NOLHGA and the guaranty system well in the future, Jensen added, as we tackle the issues of federal intervention, the new healthcare marketplace, and the constantly changing nature of insolvencies. To meet these and other challenges, we'll need to call upon the creativity and dedication that served the system so well in the ELNY receivership and other daunting situations. "We have a well-deserved reputation for being innovative," Jensen said, "and we'll need to earn those stripes again and again in the future."

Snapshots from Palm Beach

Luncheon speaker Calvin Trillin (above) entertained attendees with his tales of growing up in the Midwest, his fear of the chiggers that infest the region, and his efforts to replace turkey with spaghetti carbonara as the official meal of Thanksgiving. Guests also enjoyed live music and dancing at the NOLHGAritaville reception as well as a dinner cruise aboard the Floridian Princess *cruise ship (below).*



clear and unmistakable shift in the federal role," Vocke added. "It's not only unmistakable, it's irreversible."

Federal involvement isn't the only regulatory trend that companies need to consider, according to Vocke. International regulators such as the FSB and IAIS are also on the move. "There's a growing encroachment by these groups in how we do business in the United States" he said, citing Solvency II and ComFrame, as well as a 2013 FSB report that was "highly critical" of state regulation. The report, which received support from the Department of the Treasury, argued in favor of more-centralized insurance regulation.

Vocke said that state regulators have responded to these threats with "terrific enhancements to a system that works very well," such as the NAIC's Solvency Modernization Initiative, Own Risk Solvency Assessment, and the use of supervisory colleges to study holding company structures. But despite state-regulation's history of success and recent improvements, Vocke added, "I'm skeptical that it will stay in place the way it is now."

Industry Outlook

The focus of the 2013 Annual Meeting wasn't entirely on regulation. Dennis Johnson, President and CEO of United Heritage Financial Group, gave a follow-up to his well-received 2008 overview of the industry to see how much has changed in five years. The answer—a lot, but maybe not enough.

Johnson began by recounting his work with an industry trade group during and after the financial crisis, as he and other representatives met with then-Treasury Secretary Timothy Geithner, FIO Director Michael McRaith, and the heads of the SEC and Financial Standards Accounting Board to spread the insurance industry gospel that "insurance companies are not banks." Unfortunately, the message didn't always take.

Johnson noted that the insurance industry as a whole weathered the crisis very well, "which really punctuates the statement that we are not banks." Unfortunately, according to Johnson, the industry isn't out of the woods yet. He cited a number "looming concerns," including what he called "the creeping discussion" toward mark-to-market for non-GAAP reporting insurers as statutory rules and GAAP rules merge and the trend of hedge funds purchasing annuity blocks or entire companies, which leads to worries that "there can be a tendency to go out farther on the risk curve" for more profits.

He also cited the Affordable Care Act (ACA) as a huge concern. "In the insurance business, one of the first things we learn is to underwrite products," Johnson explained. With the advent of the ACA, "that fundamental issue of not underwriting products maybe should keep us up at night." He added that with traditional new products, "it takes about three to five years for the tsunami of claims to hit," which means there's no way of predicting what effect the ACA will have on health insurers for some time.

Johnson also cited insurance companies and governments with large pension plan obligations, which dovetailed nicely with the presentation by Phil Waldeck, Senior Vice President, Pension Risk Transfer Solutions, with Prudential Financial. Waldeck provided attendees with the background on Prudential's pension de-risking deals with GM and Verizon, in which Prudential assumed about a quarter of each company's pension obligations in the form of annuity contract obligations.

In explaining why a company would consider moving some of its pension obligations to an insurer, Waldeck said that a GM official once described the company as "a pension plan with a showroom." The GM/Prudential transaction, which involved moving approximately $25 billion in assets and liabilities, "shook up the asset management industry," Waldeck added. However, the concept of using annuities for pensions has been around since the 1920s, and the industry has "a long track record of success in delivering on pension obligations."

Waldeck explained that both the GM and Verizon deals involve separate accounts for the pension obligations, with "tightly matched assets to liabilities." He added that insurance companies are well-suited to handle these obligations—"it's a core business, we're great asset managers, and it makes sense for insurers to have longevity risk."

He also dispelled a few "myths" about the pension de-risking field, including the idea that there's not enough capacity in the industry to handle these transactions. "Capital will flow to where it's treated well," Waldeck said, predicting that the de-risking market will heat up in the next decade.

Speaking of the next decade (and beyond), Ken Frino, A.M. Best's Group Vice President, North American and Caribbean Life and Health Ratings Department, closed the meeting with a solvency outlook for the life and health industry that touched on Best's latest impairment data. Frino noted that impairments usually strike smaller companies (under $20 million in capital and surplus), and that accident and health company impairments are generally due to inadequate pricing, while life and annuity impairments are tied to investment problems.

The outlook for the industry is stable, and Frino explained that one of the key issues facing companies is low interest rates. "Overall, the industry has done well navigating the low interest rate environment," he said. Some companies are trading liquidity for yield, he added, "but in no way am I saying this is an industry-wide problem."

Frino also singled out the rise of hedge funds in the annuity industry as a cause for concern. "Historically, we always question their commitment to the business," he said. "There seems to be a greater commitment now, but the biggest worry for us is the investment portfolio."

In the life and annuity industry, A.M. Best is seeing a movement from market-based to fee-based risks and a focus on guarantee or protection products. Overall, Frino concluded, "we're seeing stability in the industry. The one thing we're watching is interest rates." ✭

Sean M. McKenna is Director of Communications for NOLHGA. All pictures by Kenneth L. Bullock.

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meeting Federal Reserve regulatory requirements, then the historical industry resistance to federal regulation may soften considerably.

Then there is the role of the FDIC as "SIFI resolver" under Title II of Dodd-Frank. I'll note again, as I have in the past, that I have a very high regard for the FDIC. They have a lot of good, smart people there who take their jobs seriously. After Dodd-Frank was passed, they formed an office of complex financial institutions resolution, and they have dozens and dozens of very highly educated, highly credentialed people on that team who probably can't wait to get busy.

Dodd-Frank also created, besides the Federal Insurance Office (FIO) and its 15 or so current, highly credentialed staff members, the Office of Financial Research, which now has a staff of about 150 smart, degreed, experienced people. Additionally, the DOL, SEC, and CFTC are all involved with insurance in different ways.

Finally, the Department of the Treasury is at the center of almost everything going on after Dodd Frank, and the position of Treasury Secretary has never been purely apolitical—it almost can't be. I read the Secretary's press release on the denial of the Prudential appeal as having a political component. Your views may differ.

Looking at it another way, there are a whole lot of new federal staff mouths to feed. That causes me to recall the work of University of Virginia economist James Buchanan, who won the Nobel Prize for developing the "public choice" mode of analysis. It's a fancy name, but the public choice school, in this connection, gives us only what an old girlfriend once described as a "penetrating glimpse into the obvious" (or "PGIO" for short): namely, that it is the inherent nature of a government bureaucracy constantly to seek to expand its size, its mission, its budget, and its headcount.

For me, the most troubling aspect of the FSOC's findings on AIG and Prudential was the lack of any real limiting principle.

The International Regulatory Front

I'm only going to touch on this topic lightly, primarily because I can't clearly think about what I saw at the IAIS meeting last week until I've fully adjusted back to East Coast time. I will say this: The current positions of the Financial Stability Board (FSB), together with the developing positions of the IAIS, seem to be converging with those of the Federal Reserve, Treasury, and the FSOC majority. I'm not sure why that's so, though I could guess. The important thing is that now, more than ever before, the international regulatory bodies and the U.S. federal bodies appear to have mutually supporting agendas.

Continuing State Interest

I also agree with Damon's observation yesterday that, while the federal regulatory role is growing, that doesn't necessarily mean that the state regulatory presence will disappear or even diminish in the foreseeable future. For one thing, the federal government agencies don't WANT the dirty work of state regulation. MIT-trained economists and Yale Law grads have absolutely no interest in taking phone calls from a consumer in Danville, Illinois, who wants to know why the insurer won't pay to get his car out of the body shop.

And as federal regulatory encroachment proceeds, state regulators will feel increasing pressure to justify their own roles, both on traditional topics of state regulation and in new areas.

In particular, states will continue to feel budgetary pressures, and they will look to their insurance regulators to do what they can to boost revenues and decrease "tax expenditures." That's part of what we've seen in a variety of areas, ranging from captive licensing to unclaimed property audits. Closer to home, we'll continue to see interest in premium tax offsets, guaranty system expenses, and maybe even funds held by guaranty associations, whether earmarked or not.

In the good news department, the more visionary state regulators have also seen that the guaranty system can be a great ally of state regulation, and for that reason some initiatives that were first proposed from within our system have seen some take-up at the NAIC and by state regulators, including, for example, the Receivership Financial Analysis Working Group, or R-FAWG, concept and increased functional uniformity of guaranty association laws.

The Industry Perspective(s)

One issue we have not touched on yet is the federal pressure to treat health insurers as public utilities, and the related implications of pressures in the health industry environment that bear on the guaranty system.

We need to begin by acknowledging frankly that the health industry—like the P&C industry—has never viewed the value proposition of the guaranty system in the way that the life industry has viewed it. Understandably so. True indemnity health insurance is a short-tailed line of business, and concerns of consumers and their agents with the long-term financial stability of a health insurer (or an auto insurer, for that matter) have never rivaled the concerns of parents buying a life policy or annuity right after their first baby is born. These are different concerns, and so there are different takes on the value of what the guaranty system achieves for companies in the two sectors, and for their consumers.

If that was true before 2010, it has become even more true since the Affordable Care Act (ACA) passed and health companies began to be told what policies and policy terms they must and must not offer, what premiums they can charge, what profits they are permitted to make, and so many other things.

It may be that John Gallina or Nick Thompson or Lee Douglass can tell us where the health industry will be in five years, but I sure can't. I will note, though, that NOLHGA research into the health-care market, some of which you heard about yesterday, showed us that the share of the health-care-financing market now occupied by indemnity health writers is remarkably small, and that, even of that share, not all market players belong to the guaranty system.

Now, more than ever before, the international regulatory bodies and the U.S. federal bodies appear to have mutually supporting agendas.

The question of where health insurance will be in five years will turn in part on where the ACA is in five years. Will the ACA succeed? Can it succeed? Some issues may yet delay or frustrate key ACA objectives, including the recent Web site problems; state decisions not to form exchanges or expand their Medicaid programs; and most important, what percentage of young, healthy individuals will opt to purchase coverage as opposed to paying a nominal penalty, or tax, or whatever you choose to call it.

I say, with no desire to make a political point, that the ACA could still fail in a number of ways. If it succeeds by its own terms, that will have complex consequences. If it fails, the consequences will be even more complex.

Finally, on the health side, there is the long-term-care insurance issue. Issues, really. There is the industry and regulatory issue of whether it's possible to make this product work sustainably on economic terms that meet the goals of both buyer and seller, both going forward and for legacy business. There are also receivership and guaranty system questions involving, first, how to think about a resolution structure for a product so different from the life and annuity contracts around which the thinking of our system developed; and second, how to equitably apportion the costs of the failure of a company that wrote long-term care business.

To put it succinctly, there are some special pressures today on health writers, and our system has to make sure that the legitimate interests of health insurers are considered and respected.

Turning to the life and annuity side of the industry, I'll note in passing a couple of points. First, as mentioned before in connection with the expanded federal regulatory role, the regulatory treatment of large life insurers—while always different in some ways from the treatment of smaller companies—is beginning to diverge even more. We're seeing more than before some different interests within the "BigCo" and "SmallCo" pools, and we have to strive as best we can within this system to make sure that we respond to the interests of both the large and small companies.

If there is a real growth area in an industry that, as Protective Life Chairman, President, and CEO Johnny Johns recently told us, faces some built-in challenges, that growth area is meeting the guaranteed retirement income needs of those who are now retiring or making serious plans to retire.

Prudential Financial's Phil Waldeck gave us a great presentation on some of the things the industry is doing to reach out to that market, and the success of the effort likely will require new products and new transactional approaches. As these are rolled out, both the industry and regulators at all levels will look to the guaranty system to contribute to the discussion of how consumers would be protected if annuities became more widely used in retirement planning. We need to engage in those conversations.

All in the Family

I said I would touch on four issues, but I am adding a fifth, though only briefly. With a world changing as rapidly as our environment now is, and with a set of new and skeptical critics looking askance at whether we're up to the job we are assigned, how much are we, as the guaranty system family, willing to stretch to make sure that we leave our institution in better shape than we found it? Are we convinced that we have the laws, the procedures, the systems, and the processes to handle the resolution of a very large insurer? If we aren't fully convinced of that, what do we need to do to get to "yes," and are we willing to do it? We're not going to answer that question today, but we *will* need an answer.

Change is never comfortable, especially to those of us who make our living from the guaranty system—NOLHGA staff and our great guaranty association administrators. But we're a membership organization, and the real question is what our 51 member guaranty associations want—and that in turn is a question for their boards and member companies. If they want change, our system can and will evolve to respond to the needs of today and tomorrow. If not, that's a choice too—a choice to entrust the future of this system and its mission to the tender mercies of others.

It has been a pleasure and an honor to serve this great organization for another year, and I look forward to working with all of you in the year to come. Thank you very, very much. ✪

Peter G. Gallanis is President of NOLHGA.

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be constantly testifying and speaking about, and where a lot of the public policy action will be from here on out.

Spotlight on the States

The FIO was careful to note that this was the beginning of a longer examination/discussion process, with federal flags planted in a whole spectrum of subject areas. Every page contains fodder for regulator, industry, and Congressional inquiry. The spotlight is on state regulation and will stay there.

The increasingly international dimension of the insurance marketplace and the role of the federal government in foreign affairs is one reason for federal involvement in insurance regulation, the report says. But it moves from that base into the argument that the ideal solution for such a major segment of the economy is not the displacement of the traditional state-based model but a critical look at areas that can and should be done better. In short, the FIO tries to get away from a pure state v. federal fight, except maybe in the mortgage insurance sphere where the report says the feds should be in charge, and instead shifts the focus to systemic improvement that should be the ultimate goal of everyone, state *and* federal. Hard to argue with that, many will say.

The New Hybrid

The report states, "The proper formulation of the debate at present is not whether insurance regulation should be state or federal, but whether there are areas in which federal involvement in regulation under the state-based system is warranted. Reframed in this manner, the basic question with respect to reforming any aspect of insurance should be whether federal involvement is warranted at this time and, if so, in what areas."

In the U.S. Department of Treasury press release you should read, FIO Director McRaith sums it up this way:

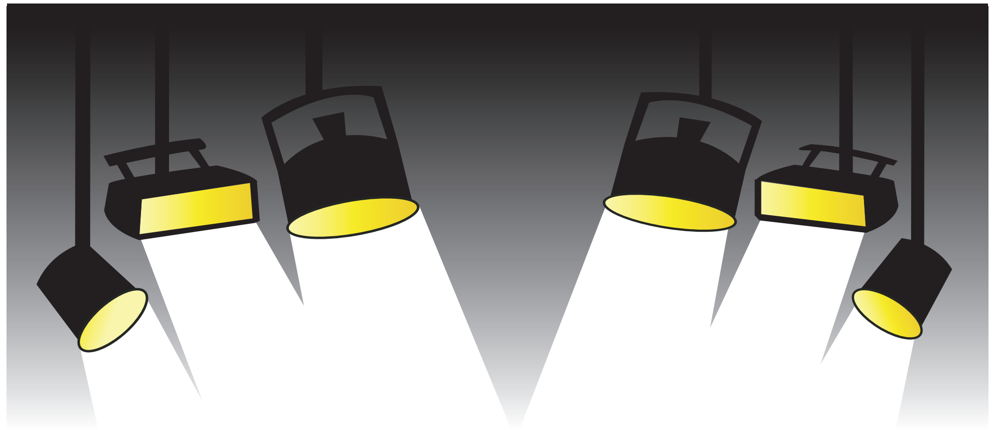
"The report reflects an extensive study of the insurance sector and benefits from the collective expertise and experience of state, federal and international supervisors. It also recommends a hybrid approach to insurance regulation that provides a practical, fact-based roadmap to modernize and improve the U.S. system of insurance regulation. Importantly, this report reflects the dynamic nature of the regulatory system for insurers and provides an explicit path for state and federal regulatory entities to calibrate involvement going forward. We look forward to continuing our work with all stake holders as the United States moves forward with modernizing insurance regulation."

I predict we will hear the words "hybrid approach" a lot. A whole lot.

Guaranty Systems & Receiverships

There is a two-page section on the L&H and P&C guaranty systems (pp. 44–45), and those systems fare pretty well.

- The report suggests that state guaranty associations should adopt uniform policyholder recovery rules (p. 44) so that all policyholders, irrespective of where they reside, receive the



The FIO tries to get away from a pure state v. federal fight…and instead shifts the focus to systemic improvement that should be the ultimate goal of everyone, state *and* federal.

same benefits from guaranty associations. It goes on to say that if states fail to do so, federal involvement to "ensure fair treatment of all policyholders" may be necessary.

- On the point of guaranty system financial capacity, the report states, "…Despite significant apparent capacity in the guaranty fund system, it is unclear how the system would fare in the event of a failure of a large insurance group in the United States."
- The report recommends that NOLHGA and the NCIGF model such "large failure" scenarios and have their work reviewed by the FIO (p. 45).

Finally, there is a section on resolution and receivership (pp. 42–44) right before that on the guaranty functions that is certainly worth reading. There are key suggestions for receivers on uniformity, transparency, derivatives/QFCs, and receiver reporting designed to drive improvements in the receivership process. All are things receivers should think about and consider carefully, because that is what the FIO will be doing.

So add to your reading list pp. 42–45 of the FIO report (if you haven't already)—the sections on the receivership and the guaranty systems. In fact, put those pages at the top.

That's my roadmap. I hope you will invite me back to the *Journal* to dig deeper as the conversation in Washington about the FIO report accelerates in 2014 and beyond. ✯

Charles T. Richardson is a Partner with Faegre Baker Daniels.

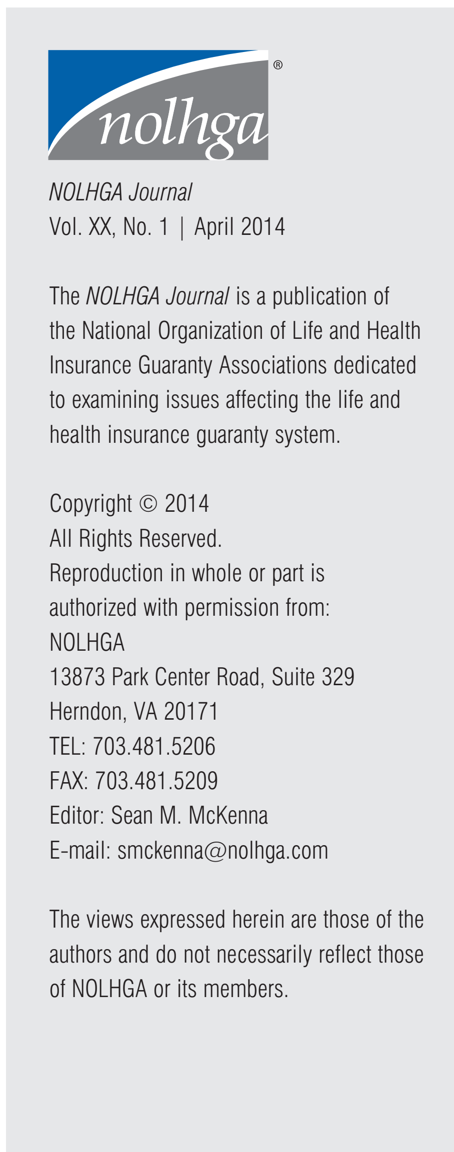
End Notes

1. A copy of the FIO's First Annual Report can be accessed at www.treasury.gov/initiatives/fio/reports-and-notices/Documents/FIO%20Annual%20Report%202013.pdf.
2. A copy of the FIO's Modernization Report can be accessed at http://www.treasury.gov/initiatives/fio/reports-and-notices/Pages/default.aspx.

NOLHGA Calendar of Events

2014

May 13–14	NAIC International Insurance Forum Washington, D.C.
July 15–16	**MPC Meeting** **New York, New York**
July 17–18	**NOLHGA's 22nd Legal Seminar** **New York, New York**
August 16–19	NAIC Summer National Meeting Louisville, Kentucky
October 7	**MPC Meeting** **San Diego, California**
October 8–9	**NOLHGA's 31st Annual Meeting** **San Diego, California**
October 19–21	ACLI Annual Conference Washington, D.C.
November 16–19	NAIC Fall National Meeting Washington, D.C.



NOLHGA Journal
Vol. XX, No. 1 | April 2014

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

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NOLHGA
13873 Park Center Road, Suite 329
Herndon, VA 20171
TEL: 703.481.5206
FAX: 703.481.5209
Editor: Sean M. McKenna
E-mail: smckenna@nolhga.com

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