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"We've Lost Sight of that Core Mission"

Protective Life's Johnny Johns discusses the fallout from the financial crisis, a possible hybrid state/federal regulation scheme, and how the life insurance industry risks losing its focus

The following is an edited transcript of my interview with John D. Johns, the Chairman, President, and Chief Executive Officer of Protective Life Corporation. The interview took place at NOLHGA's 2012 Legal Seminar on July 26.

Peter G. Gallanis

Gallanis: *You probably gathered that most of the people who attend this seminar are lawyers. You come to your position with backgrounds both in the finance and business world as well as extensive experience as a lawyer. How have legal training and your experiences, both in private practice and as a general counsel in a big corporation, influenced the way you go about your day-to-day job as CEO?*

Johns: I think I certainly have a much deeper appreciation and respect for the law than do many in the business world who haven't labored in the trenches, and I have great respect for lawyers. I'm very blessed to have a great general counsel in Debbie Long. Most people my age spend some of their time—at least I hope they do—trying to mentor younger people, children of your friends who want to come by and talk about how to think about a career and life. And one bit of advice I always give is, get into a discipline. It doesn't matter whether it's law or accounting or engineering or science, but something that really forces you to work extremely hard and pay attention to detail. Because I think most of the mistakes I see made in the business world are made by people who try to paint things with a very broad brush and don't appreciate that the devil is truly in the details—as well as the angels, sometimes.

What I liked about being a lawyer was the intellectual challenge of really having to understand something from many different dimensions, to be able to detach your emotions from an issue and just face the brutal facts—whatever they are. I think that's what great lawyers do. They're able to cut through to the realities of a situation and articulate that in a way people can understand.

But I just think the discipline of paying attention to detail and appreciating how important it is to know your facts, to really know what you're talking about, is what you have to do to be a good lawyer—and is an essential lesson in life. And I think I benefit greatly from the training and mentoring I had as a lawyer.

Gallanis: *One of the major goals at your* alma mater, *Harvard Law—at least according to a certain movie—is teaching students how to think like a lawyer. As a CEO, do you ever have to force yourself* ***not*** *to think like a lawyer?*

Johns: I do.

["Johnny Johns" continues on page 13]

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The Change We Need & How to Find It

The 2012 NOLHGA Legal Seminar is now history, and I'm grateful to all the participants and presenters who made this our finest Seminar ever. I'm particularly grateful to Planning Committee Chair Chuck Gullickson, NOLHGA Counsel Meg Melusen, and the Seminar's *eminence grise*, Charlie Richardson, for nailing both the large and the small details perfectly. (A Legal Seminar recap is included in this issue.)

While I learned a great deal from every one of the Seminar presentations, there was one in particular about which I continue to reflect weeks afterward. The panel to which I refer was the discussion of the PPACA Supreme Court litigation by two lawyers on opposite sides of that case, Gregory Katsas and Neal Katyal.

I think about this presentation particularly because we are approaching another presidential election season, and the campaign behavior of candidates at all levels and on all parts of the political spectrum has so far this year seemed, if anything, even less substantive and enlightening than we have seen in other recent campaigns. Our country is facing serious challenges in the economic recovery, job creation, deficit control, tax reform, foreign affairs, national security, health-care delivery, education, and so many other areas. Serious thought and hard work are required from the best people in government to address these challenges. Our political campaigns are supposed to help voters select the best people to confront such challenges, but in recent years, campaigns have focused too little on serious discussion of the issues and too much on smears, slogans, mischaracterizations (or worse), and "gotchas."

Few issues have been as divisive and emotionally charged as the PPACA (health-care reform) legislation enacted in 2010, which was upheld by the Supreme Court just weeks before the Seminar in what may have been the most significant and closely watched Supreme Court case since *Roe v. Wade.* Against that background, few would have been surprised if Messrs. Katsas and Katyal had torn into each other using the sort of rhetoric now all too familiar from politics (and increasingly common in the practice of law).

What surprised and delighted me was that they did precisely the *opposite.* We saw on that panel two extremely intelligent, articulate young lawyers—both former U.S. Supreme Court clerks—with complete mastery of the legal and factual elements of the case, who conducted a cordial, mutually respectful, objective, and informative discussion of a difficult and controversial topic. Theirs was a conversation and a professional relationship that, at least to me, epitomized the very best sense of the term "old school." Particularly at an event geared primarily to lawyers, it was instructive at a level unrelated to the immediate topic (the PPACA Supreme Court litigation) that two young aces like these could so defy contemporary stereotypes of scorched-earth litigation and the litigators who practice it.

Call me naïve if you like, but after the civil but productive discussion between Messrs. Katsas and Katyal, I wondered why we shouldn't demand that quality of debate on other questions where opinions now diverge, both on issues of national scope and ones of more narrow concern.

Too often, the type of debate we see in today's politics infects the way we conduct discussions in the real world. As in politics, ordinary discussions increasingly are debased by the use of straw men, *ad hominems*, red herrings, shibboleths, special pleading, faulty generalization, appeals to prejudice and emotion, and similar sophisms.

Political debates should require labels reading, "Don't try this at home."

It's a bad idea for people in private life to imitate actors

on the political stage, because the goals of "debating" in the political world and addressing issues in the real world are very different.

I believe, as someone who has watched elections back to 1960, that the real objective of debating in politics (at least the campaigning part of politics, and campaigning now seems perpetual) is now almost solely to get elected (or reelected). Too often serious discussion of policy, and the ways and means of governing, are far, far less important to candidates than that primary goal of winning elections.

When winning is virtually the only thing that matters, what politician or political strategist cares if the use of *ad hominems*, straw men, red herrings, and other logical fallacies causes whatever arguments are framed in the political debate to lead hopelessly far from logically and factually supportable conclusions?

Asking the Right Questions

Whatever may be the sad reality in politics, policy debates in the real world—in business and in other walks of life—have a different goal. Because the goals of real-world debates are different, the methods of debate should also be different from those usually followed in political campaigns.

By this I mean that when we debate policy for any well-managed organization, we are primarily asking three questions: First, is it important that we change something about the organization, and if so, precisely what? Second, what resource allocations, implementing steps, and other consequences will the proposed change require? Finally, is the importance of the proposed change sufficient to justify all of the costs of pursuing it? Stated differently: Do we *need* to change? What would it *cost* to fix it? And is the fix *worth* the cost?

Of those three inquiries, the first is often the most overlooked, particularly if the discussion veers into the type of discussion often heard in politics.

All policy debates to some extent involve potential changes that an organization could make, and few changes are seriously proposed about which *nothing* good can be said. But precisely because changes may have costs and consequences that outweigh any benefits, a searching and fearless policy debate will always begin with the question, "Is this proposed change *important*—something the organization must pursue to meet an unmet organizational *need*—or is it more like a solution in search of a problem?"

A political-style debate often jumps the tracks at this stage. The reason is that, because a candidate wishes primarily to defeat his opponent, discussion of the topic is tethered little (or not at all) to practical needs, costs, value, or, for that matter, whether the argued-for change is ever likely to be effected. A political candidate can score debate points merely by creating an impression that he or she favors the Apple Pie Bill, regardless of its costs or consequences, regardless of whether it is likely to be adopted, and regardless of whether the Apple Pie Bill is actually needed to advance any interests of the voters.

In that sense, being "for" the Apple Pie Bill is a wedge issue that separates candidate A from B, who may express completely legitimate concerns about costs, consequences, and the like, but who risks then being perceived as "anti-Apple Pie." To A, the political calculus indicates that the electability benefits of being seen as for Apple Pie are more important than any arguments against it, and thus that calculus drives A's position.

A Better Way

Different objectives and a different calculus guide policy debates in a well-governed organization. In any well-governed organization, the directors and the shareholders or members who elect them are interested primarily in the welfare of the organization, and not any element of personal benefit. As a consequence, a good organization will always review proposed

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changes using some version of the three-stage analysis (need/cost/worth) described above, starting with the needs analysis.

To diverge from theory and look at a real-world case, I'd like to illustrate one application of that type of practice that was followed by the Board of Directors of NOLHGA.

As many *Journal* readers know, the NOLHGA Board takes seriously the need to periodically study and reassess the organization's strategic priorities. To that end, beyond its regular in-person meetings, the Board periodically engages in an exhaustive strategic planning process. The latest one was conducted in August of this year. The one before that was conducted in 2007.

The point of the strategic planning process is to assess the organization's material strengths and weaknesses, identify any strategic threats to the organization, and note any opportunities for better fulfilling the organization's mission. To the extent that feasible and cost-justifiable changes are identified, those changes are then worked into NOLHGA's organizational goals, which in turn the Board uses to monitor and evaluate the organization's effectiveness and productivity.

The Board begins that process by conducting a painstaking inventory of relevant organizational concerns. To identify material concerns about the organization, independent professional facilitators conduct detailed, wide-ranging "stakeholder interviews" with a large number of people working in the guaranty system and with others (regulators, receivers, company officers, and trade association officers) who deal with the system from the outside.

The facilitators then distill the results of these interviews (without attributing comments to any sources) into a chart of strengths, weaknesses, opportunities, and threats (a "SWOT chart") and a list of discussion topics. The entire Board and senior NOLHGA staff then participate in a full-day discussion, moderated by the independent facilitators, of the SWOT chart and topics generated from the interviews. By the end of that day, the Board identifies areas where change appears needed, feasible, and cost-justified, with the objective of working those changes into NOLHGA's organizational goals—the standards by which the organization's effectiveness and productivity are measured.

The Need for Transparency

A strategic planning process of that type—and its results—can be understood by looking at one area of organizational weakness identified in the 2007 strategic review that was subsequently addressed by the Board.

The stakeholder interviews conducted in 2007 produced a number of comments from interviewees to the effect that (among other issues) NOLHGA needed to do a better job at "constituency relationships." More specifically, the comments pointed to the need to communicate more clearly and effectively with NOLHGA's members and with external parties (including regulators, receivers, policyholders, and "opinion leaders"). In addition, the comments suggested making the operations and decision-making of the NOLHGA Board more transparent to and inclusive of NOLHGA's members.

At the conclusion of the 2007 strategic planning process, the Board resolved to take concrete steps to address these issues, and a detailed set of action steps (including revisions to NOLHGA's organizational goals) was developed and enthusiastically supported by the entire Board.

An initial challenge was determining how to involve and inform NOLHGA's "members" when—as Dan Orth from the Illinois association frequently notes—the *only* members NOLHGA has are its 52 member guaranty associations, which are obviously "non-natural persons." Companies are not members of NOLHGA; neither are company officers, or guaranty association administrators, or state guaranty association board members, or members of the NOLHGA staff—although all of those in a loose sense are critically important members of the guaranty system family.

The challenge, in other words, was to find ways to involve and inform the individuals most critical to the system's functions.

Some steps were obvious and were implemented immediately.

No organization is perfect, and NOLHGA—like any other entity—can and will make changes to improve its performance.

> Political debates should require labels reading, "Don't try this at home."

For example, on the topic of transparency of NOLHGA Board operations, some 2007 interviewees suggested that minutes of NOLHGA Board and committee meetings be posted to the NOLHGA Web site. In fact, they were already then being posted to the site, although that fact apparently was not widely known. To raise awareness, various NOLHGA publications noted the posting of those meeting minutes.

As an additional transparency step, the Board also directed that the staff's management report to the Board—a written *précis* of staff and organizational activity—be distributed to all guaranty association board members and administrators immediately after Board meetings to provide real-time reporting of matters receiving the Board's attention.

Beyond the distribution of minutes and management reports, the NOLHGA Board began a program of inviting the board chairs and executive directors of member guaranty associations to attend and participate in NOLHGA Board meetings and associated committee functions. By now, the chairs and executive directors of nearly all member associations have attended or been invited to participate in NOLHGA Board meetings, and NOLHGA staff participation in guaranty association Annual Meetings has likewise increased.

Additional steps have included outreach to encourage guaranty association board members to attend NOLHGA Annual Meetings, Legal Seminars, and MPC meetings. As a result, state board member participation in those events has reached an all-time high level.

One particularly critical element of transparency improvements has been recognition of the essential role played in NOLHGA by guaranty association administrators. The Board appreciates the key contributions of administrators and accordingly has supported the gradual increase in the number of administrators serving on the NOLHGA Board, to the point where the Board has included no fewer than four administrators for at least the past 6 (and 10 of the past 11) years.

Moreover, the Board's Executive Committee (EC) has for an even longer time regularly included the MPC Chair (an *ex officio* member of the NOLHGA Board) in the telephonic meetings of the EC. Last year, NOLHGA's corporate governance guidelines were amended to formally recognize the value of including the MPC Chair in EC meetings, and outgoing MPC Chair Mike Marchman reports that the process is working very well.

The Board also directed measures to improve communications to those "external constituencies" with whom we do important work in the regulatory, receivership, trade association, legislative, academic, and journalistic communities. Driven in part by the communications findings of the 2007 strategic planning process, and also by the requirements of the recent economic crisis, the Board required development of a new work plan for educating both internal and external constituencies about the capability and performance of the guaranty system. The various publications, white papers, Web site improvements, and one-on-one contacts flowing from that work plan served the system very well through the crisis and the ensuing legislative debates.

Positive Results

How well have all of these steps worked?

As a great courtroom lawyer, Abraham Lincoln—also my kind of politician—recognized, sometimes the most powerful evidence is the dog that does *not* bark. While the extensive interview process for the 2007 strategic planning exercise generated a number of comments from interviewees about the need for improvements in communications, openness, transparency, and participation in activities of the NOLHGA Board, the interviewees in the substantially similar 2012 process raised virtually no such concerns, and accordingly (unlike in 2007) the Board identified no need for additional change in these areas.

No organization is perfect, and NOLHGA—like any other entity—can and will make changes to improve its performance. Change, however, should be driven by a demonstrable need for improvement and by considerations of associated costs and value.

The analytical methods reflected in the Board's strategic planning exercise and demonstrated in the Board's successful efforts to "open up" its activities are a helpful case study. That case study illustrates how an organization can conduct an internal discussion that is cordial, mutually respectful, objective, and informative on the way to identifying improvements that are really needed and that can and should be accomplished. ✯

Peter G. Gallanis is President of NOLHGA.

The Daily Times

EXTRA! EXTRA!

Enjoy the Bad News

A lineup of great Legal Seminar speakers didn't have much encouragement to offer, but one thing's for sure—the next few years aren't going to be boring

By Sean M. McKenna

Boston proved to be the ideal host city for NOLHGA's 2012 Legal Seminar. The July weather was perfect, the venue was beautiful, and being in Massachusetts set the stage nicely for discussions about health-care reform and the presidential election.

More importantly, however, Boston is a city that knows how to be depressed, thanks to its long and—until the last decade or so—largely masochistic fascination with the Red Sox. The fatalism that once permeated the city is still present (especially with the Sox needing a telescope to spot the Yankees in the standings), and after two days of presentations on the weak economy, disturbing trends in insurance industry litigation, the ballooning national deficit, and regulatory upheaval, the almost 200 guests who attended the seminar could be forgiven for being a little glum about the future.

But thanks to an outstanding speaker lineup that made everything from Solvency II to deficits and taxes entertaining and sometimes downright funny, it's safe to say that few audiences enjoyed hearing bad news as much as this one.

Another Washington Conspiracy?

The largest panel discussion of the seminar tackled one of the most important issues—the changing regulatory landscape two years after passage of the

The Honorable David Walker, founder and CEO of the Comeback America Initiative and former Comptroller General of the United States, provided an entertaining and at-times shocking analysis of the country's deficit troubles. "Congress is broken, and spending is a bipartisan problem," Walker said, adding that only a combination of tax reform and spending decreases can fix the deficit.

Dodd-Frank Act (DFA). Moderator Charles Richardson (Faegre Baker Daniels) set the stage by noting key elements of the Act that will have an effect on the insurance industry, such as the designation of systemically important financial institutions (SIFIs) by the Financial Stability Oversight Council ("most observers contend that few if any insurers are financially significant," Richardson said) and the long-anticipated report on financial services regulatory modernization by the Federal Insurance Office (FIO).

Richardson reminded the audience that "while we continue to wait breathlessly" for the FIO report, the FIO has more on its plate. "FIO's emphasis seems clearly in the international realm," he said, "but that's not the only place it may make its presence felt." Richardson also described the renewed interest in the guaranty system safety net from several federal agencies, including the FIO.

There's been some talk of repealing the DFA, but Tom Glassic (General Counsel of the D.C. Department of Insurance, Securities and Banking), who served on the staff of the House Financial Services Committee when the DFA was drafted, debated, and passed, said that the conversation hasn't displayed the "great level of fervor" that's surrounded health-care reform discussions. He added that even though a large number of regulations have yet to be written—"the terrible twos may still apply to Dodd-Frank"—the Act seems to be in no real danger. "Dodd-Frank is here to stay."

Maureen Adolf (Prudential Insurance Company of America) agreed with Glassic. Prudential faces the prospect of being declared a SIFI, and while repeal would solve that problem, "it seems clear to us that's not going to happen," she said. Rather than pushing for repeal of the Act, Prudential is trying to educate the FSOC on why Prudential, as well as the industry as a whole, doesn't pose a systemic threat—and they're looking to the states for assistance. "We're appealing to state regulators," she said, "and trying to explain our perspective as we approach federal regulators."

Scott Campion (Oliver Wyman) said that Prudential has a persuasive case to make. "We feel strongly that core insurance activity is not systemically risky," he said. "The key to systemic risk is interconnectedness, and you don't see that in insurance." Insurance is already highly regulated, Campion added, "and layering something on top of that might not be the best use of regulators' time."

Cynthia Martin (Federal Reserve Bank of Boston) said that the financial crisis "highlighted where some of the frailties were" in financial services regulation, and the DFA was designed to shore up these areas. She acknowledged the frequent criticism that the Act is too "bank-centric" at the expense of the insurance industry, but she noted that there are similarities between the two industries. The Federal Reserve is learning more and more about the insurance industry, she added, and it intends to be flexible: "No two entities are the same."

Things took a strange turn when George Nichols (New York Life Insurance Company) suggested a conspiracy theory related to the DFA: "Was Dodd-Frank a subtle attempt to drive the insurance industry into federal regulation?", he asked. Unlike many conspiracy theorists, Nichols offered some points to prove his case.

The first point was the likelihood that federal standards for regulating SIFIs will

come to apply to all large insurers. "Large companies will adapt these standards voluntarily as best practices" to show that they're operating as well as any SIFI insurer, Nichols said. He also pointed out that the FIO, though it has no regulatory function, has the power to gather information and report to Congress: "One could argue that's limited power, but it's significant power." The DFA and its newly created agencies, combined with continuing economic and regulatory trouble, could be driving the industry toward "de facto federal regulation," Nichols said.

Glassic agreed that Nichols's conspiracy theory was on the right track. "Dodd-Frank has a lot of optional federal charter in it," he said, noting that a "perfect storm" of trends in Congress and the property and casualty industry make it highly likely that the federal government will step into catastrophe insurance. "When you talk about catastrophe insurance, everyone's a socialist, or at least a Keynesian."

During a lively Q&A session, Adolf praised the state-based system of solvency regulation but predicted trouble ahead. "There are lots of factors contributing to whether the state system remains viable," she said. "It has to keep changing."

Nichols spoke about the global marketplace of insurance and insurance regulation, saying "I would like to see the United States lead in the debate about insurance regulatory policy." Addressing the Solvency II initiative in Europe, he added, "we have a much more sophisticated system that has proven itself."

Massachusetts Insurance Commissioner Joseph Murphy provided welcoming remarks to seminar attendees. He called his state "the birthplace of health reform," noting that Massachusetts had achieved "near universal health insurance coverage" for its residents. He added that the insurance department's focus is now on cost containment.

International Intrigue

Solvency II was also on the minds of the seminar's international regulation panel, which was moderated by Sara Powell (Faegre Baker Daniels). Tom Finnell (FIO) observed that U.S. companies are worried about the possibility that the U.S. regulatory system might not be deemed "equivalent" to Solvency II, which could bring on a host of additional regulatory requirements. Leigh Ann Pusey (American Insurance Association) echoed these comments. "We have to bridge the gaps" in the relationship between the U.S. and EU regulatory frameworks, she said. "That's an imperative."

Pusey also noted that there's "a fundamental difference in philosophy" between the two camps when it comes to how capital is treated in solvency regulation. "The U.S. position is to defend risk-based capital requirements."

Brian Atchinson (Physician Insurers Association of America) said that in his opinion, "there's some degree of hubris" in the EU attempting to impose Solvency II on the global marketplace. "The U.S. system has a pretty good track record," he said. "I was very pleased to see the pushback on Solvency II" by U.S. regulators. He added that European companies, which once supported Solvency II, "now think they've created Frankenstein." Pusey agreed, adding that the companies want to let the monster loose. "What they thought was going to create a more competitive world is now burdening them, and they want to share that burden."

Talk turned to the International Association of Insurance Supervisors (IAIS) and its recently released ComFrame document, a plan for regulating internationally active insurance groups and fostering global convergence of regulatory and supervisory approaches. Finnell, who noted that the FIO has been working closely with the IAIS, called the ComFrame goals "laudable" and said the plan is "fairly far-reaching in the regulations it would impose on companies and the supervisors of those companies." The danger, he added, is the potential to add layer upon layer of regulation—domestic regulators, international regulators, ComFrame, and perhaps even a SIFI designation. "If

Even in the victory, Katyal saw some ominous signs. The Court ruled that the government could not compel state governments to increase Medicaid coverage by threatening to withhold Medicaid funding.

you're a company, you would hope the regulators are sufficiently aligned so you're not jumping through different hoops."

Atchinson said the ComFrame proposal "has provided a lot of good discussion," adding that a fine template for regulatory cooperation already exists in the NAIC and its Financial Analysis Working Group (FAWG), which employs peer-review of a regulator's handling of a troubled company. "FAWG's an extremely powerful functional mechanism that has worked for years," he said. "There's no substitute for that degree of peer pressure and expectation."

In response to a question from Powell concerning international study of guaranty mechanisms, Finnell noted that a recent paper on the subject by the European Insurance and Occupational Pensions Authority (EIOPA) had advocated pre-funding of guaranty schemes. "In the United States, the system we have has worked very well," he said, and the merits of the U.S. post-funded system were stressed in comments on a draft of the paper that were submitted by the FIO.

Atchinson, who served on the board of the Florida Life & Health Insurance Guaranty Association at one time, came down squarely on the side of post-funding, saying that a pre-funded pool of money would be too tempting to politicians. "I've seen it time and again," he said. "Clever politicians will get the money" no matter what roadblocks are put in place to stop them.

Pusey agreed with Atchinson about the strength of the U.S. approach and about politicians raiding the funds. She added that the fact that the system was left in place by the DFA was "a real success that's going to help us in these global conversations."

Health Care: What Happened & What's Next?

Two panels, both moderated by Charles Gullickson (South Dakota Life & Health Insurance Guaranty Association) took different approaches in analyzing the health-care debate. The first featured Greg Katsas (Jones Day), who argued against the Affordable Care Act (ACA) before the Supreme Court, and Neal Katyal (Hogan Lovells), a former Acting Solicitor General of the United States who argued for the ACA before the Appellate Court. Katsas took issue with those who said his side "won"—even though the Act was upheld—because of the Court's ruling on the limits of the government's powers under the Commerce Clause. "We did get a lot more than most losers get," he said. "But ultimately, what we lost was a lot more important than what we won."

Katsas explained that the fight against the ACA's individual mandate centered on the government's assertion that the mandate was within its powers enumerated in the Commerce Clause. Opponents of the ACA argued that compelling participation in a market (by the mandate) is different than regulating participation and was an over-reach by the government. "If the government's rationale for compelling health care makes sense, it works for anything," he said.

The Supreme Court agreed that the Commerce Clause didn't justify the mandate. "Unfortunately for us, the Court didn't stop there," Katsas said. Instead, by a 5-4 majority, the Court upheld the mandate as a tax. "Some would say we won on the Constitution and lost on the statute." Katsas's fear, he said, is that while "we did create good Commerce Clause precedent," the Court's ruling allows for an "end run" around that precedent using the government's taxing powers. For that reason, he added, "the victory is at best Pyrrhic."

Katyal, who argued that the ACA was constitutional, disagreed with much of what Katsas said, but in a surprising way. "It's a pretty awesome and difficult thing to challenge the government," he said. "Greg played an incredibly important role in our constitutional system. And a lot of the principles Greg was fighting for did win."

Katyal said the government argued the constitutionality of the ACA on three fronts: the Commerce Clause (which the Court ruled against), the Necessary and Proper Clause (again, the Court ruled against), and the taxing power. That was the argument that won, but it came as a surprise to many. "It was about seven or eight minutes before Justice Roberts got to the tax part," Katyal said. "We all thought the Affordable Care Act had been struck down, and we weren't even watching CNN or FOX."

Even in the victory, Katyal saw some ominous signs. The Court ruled that the government could not compel state governments to increase Medicaid coverage by threatening to withhold Medicaid funding. "That does strike me as a remarkable ruling," he said.

Now that the ACA has been declared constitutional, what's next? Not surprisingly, considering the law isn't slated to be fully implemented until 2014, it's difficult to say—and not just because the Republican Party has promised to repeal it if they take the White House back.

Susan Voss, Commissioner of the Iowa Insurance Division, had some advice for those still stewing over the Supreme Court's decision. "You lost—get over it, and let's move on with health care reform," she said. "We need to find a way to get everybody

Greg Katsas (left) and Neal Katyal engaged in a lively and informative discussion about the Supreme Court's ruling on the constitutionality of the Affordable Care Act and the likely implications of the Court's ruling.

to be part of the solution." The solution, in her mind, revolves around lowering costs—something the ACA failed to address. "We need to take an in-depth look at what's happening with the cost issues," she said, which includes holding providers' and consumers' feet to the fire.

Looking to the future, Commissioner Voss predicted "large rate increases" and some less-than-enjoyable rate hearings. "I have an obligation as a regulator that the company doesn't go insolvent," she said. "But it's very difficult to explain the math of health care to consumers."

Carl Patten Jr. (Florida Blue) said the Court's ruling didn't bring the certainty to the situation that many expected. He predicted that many states would hold off on deciding whether to expand Medicaid till after the November elections, but he expects changes in the future, including "a shift from paying for more to paying for value." This shift would entail a move toward consumers playing a greater role in their health-care decisions, which would itself require them to be better educated so they can make good decisions. "Who puts out that information," Patten asked. "The source has to be trusted."

Vince Ventimiglia (FaegreBD Consulting) predicted "lots of posturing and no action" till after the elections, adding that the lame duck session of Congress will be a prime opportunity for "legislative efforts by centrists to change PPACA." These changes are likely to occur no matter which party wins the White House, he added, with modest changes in a mixed government scenario (changes to the mandate, premium subsidies, and the Independent Payment Advisory Board, or IPAB) and more extreme changes if the Republicans take control of the White

Top of the Hub, Ma!

The Legal Seminar Welcome Reception at Prudential Tower's Top of the Hub offered guests a chance to network and take in spectacular views of Boston.

House and Congress. Even if the Democrats keep the White House, however, "PPACA is not likely to remain as written."

Life's Certainties

As the old saying goes, "there are two certainties in life insurance—the death master file and taxes." The Legal Seminar had presentations on both.

Aaron Van Oort (Faegre Baker Daniels) and Phillip Stano (Sutherland, Asbill & Brennan, LLP) conducted a presentation on unclaimed property and the Social Security Death Master File, with Van Oort explaining that the issue is being driven by state budget deficits (one estimate has the states sitting on $33 billion of unclaimed property) and the role of private auditing companies, which get a percentage of the proceeds from their efforts.

Insurance companies proved to be an inviting target, in part, because "there's a good sound bite," Van Oort said. "The industry is already using the death master list" to check on annuity benefit payments. That made companies an easy target, and target practice has proven to be very popular with state governments.

"The companies currently under audit are the starting point," Van Oort said. "This will eventually come find you." When it does, he added, your company will be mired in issues such as new regulations on how often to check the master file and how to determine whether a partial match triggers a duty to investigate further. Many of these questions have yet to be answered definitively, he said, and "there's likely to be a fair amount of litigation on this" in the future.

Stano zeroed in on the changing requirements companies now face. Policy language doesn't call for any search of the death mas-

ter file, he said, but regulators have recently held that the asymmetrical use of the file (companies using it for annuity payments but not death claims) preempts or trumps the policy language. "Once you start to apply extra-contractual obligations, there's no stopping point," Stano said. "It's regulation by settlement."

John Hancock, Prudential, and MetLife have recently reached settlements with regulators, but as Stano explained, "the settlements are the beginning of the process." The next steps involve a work plan for continuing audits, continuous checking of the death master file, and bringing on new staff to handle the additional workload. "It's a monstrous task," he said—one that can take 24 to 36 months to complete.

It's also an expensive one. One alternative to the audit/settlement route is a Voluntary Disclosure Agreement (VDA), which allows companies to come forward on their own, before an audit begins. "For the state, it's found money" Stano explained. And for companies, "it's an alternative to waiting for your turn at the guillotine."

On a more cheerful note, Ken Kies of the Federal Policy Group gave attendees the most entertaining tax presentation in Legal Seminar history—perhaps because he talked about a lot more than simply taxes. He began with some sobering news. "The economic outlook is so bad that the fiscal nightmare could get worse," Kies said, reminding everyone that the country's deficit is "historically unprecedented" outside of the World War II years.

Things are looking bad on the state level as well, with states running huge deficits and cutting jobs. "Their problems aren't going to get better anytime soon," he said, adding that it's inevitable that more cities will file for bankruptcy.

Thanks to the deficit problem, Congress is once again focusing on tax reform, with a large chunk of the tax code set to expire at the end of 2012. "The theme is tax expenditures," Kies said, noting that the tax benefits for the inside buildup in life insurance products have an estimated total of $149 billion from 2010 to 2014. This has not gone unnoticed. "Life insurance is getting a lot of attention in the press, and it's often not positive," Kies said. "The attacks are bipartisan. The problem is that you can be at the table and on the menu."

The future of tax reform depends on the results of the November elections, and Kies laid out two possibilities. If President Obama is reelected, Kies predicted that Congress will use the lame duck session to extend the Bush tax cuts for households making under $250,000 and fix the alternative minimum tax, but comprehensive tax reform will be tough sledding. If the Republicans take the White House and both houses of Congress, look for no movement during the lame duck session. Instead, Kies said, there will be a budget resolution early in the Romney presidency, which will allow the Republican Party to pass tax reform using the reconciliation process, which only requires 51 votes in the Senate.

GAs Go Hollywood

Two Legal Seminar presentations focused solely on guaranty association issues, and both had a dramatic bent—the annual litigation and legislation wrap-up was based (loosely) on the classic 1980s movie *Bill & Ted's Excellent Adventure*, and the presentation on the issues surrounding receiverships and long-term runoffs featured participants acting out their roles in a mock insolvency.

Bill O'Sullivan (NOLHGA) and Tad Rhodes (Oklahoma Life & Health Insurance Guaranty Association) addressed a series of litigation and legislative issues that could affect guaranty associations. A recent ruling in an Arizona case in which the state government tried to seize funds held by the Arizona guaranty fund ("a nightmare scenario for me," Rhodes said) was decided in favor of the Arizona fund, and an analysis of the COOP program proposed under the Affordable Care Act indicates that these companies will likely be considered guaranty association members.

O'Sullivan explained that a new NCOIL Model Act would require companies to make semi-annual checks of the death master file. While this creates "a completely new precedent," he said, the law "clearly applies only to insurers" and likely has no implications for guaranty associations. O'Sullivan also reported that 37 states have updated their association statutes in the last four years, with 31 states being "functionally consistent" in key segments of the statute.

For the presentation concerning a mock insolvency in the mock state of East Dakota (a state in which every insurance company, for various reasons, eventually fails), moderator Joel Glover (Rothgerber Johnson & Lyons) led an acting troupe featuring Bart Boles (Texas Life & Health Insurance Guaranty Association), Jim Mumford (Iowa Insurance Division), and Joni Forsythe (NOLHGA) as they staged a meeting between a Deputy Insurance Commissioner and representatives of a NOLHGA task force.

With a cameo by Tad Rhodes as the morally flexible East Dakota Insurance Commissioner, the participants reviewed many of the issues facing an insurance department when a domestic company experiences financial difficulty: political fallout from loss of jobs, a commissioner angling for reelection, and even confidentiality concerns about communications with the guaranty system being open to Freedom of Information Act requests (these communications are excluded from such requests in most states).

Amid the verbal sparring between Boles and Mumford (who had to be separated on more than one occasion), Glover and Forsythe provided a calming influence as the panel addressed many of the problems common to life and health insolvencies: a backlog of health claims, preserving provider networks to make things easier for policyholders, site visits by the task force in advance of taking over the business, staffing decisions, reinsurance, and even tax issues. Mumford stressed that insurance departments face a host of pressures and are often looking for any help they can get. "I didn't realize how much pressure there is on a public official till I came over to the regulatory side," he said. "Anything the industry and guaranty system can do to lessen the public relations issues is helpful." ✯

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

["Johnny Johns" continues from page 1]

Gallanis: *Tell us a little about that.*

Johns: I think there is a certain amount of risk aversion that goes along with giving legal advice. One of my great mentors in the Maynard Cooper firm told me that the difference between a trial lawyer and a corporate lawyer—I was a transactional business lawyer at the time—was that a litigator is like a bowler. If he scores 220 out of 300, he can win. Not so in the corporate world. You need to score 300 most of the time. Your clients don't need many gutter balls. But sometimes you have to get out of that mindset and realize you're more like a litigator. You have to take chances. There's risk in everything you do, and you have to make principled decisions.

Gallanis: *I'd like to go back to a point that was touched on briefly by Commissioner Murphy in his excellent opening remarks. We're coming out of, or at least we hope we're emerging from, an extended financial crisis and a period of serious economic stress—especially what we saw peaking in late 2008 and early 2009. If there is one thing that you could have the general public understand better about the insurance industry and this period of financial stress, what would that be?*

Johns: I think the Commissioner said it very well: that the industry did come through the financial crisis in relatively good shape. It demonstrated many strengths of the state-based regulatory system. One of the most important things that people don't understand about the life insurance industry, which is really all I can speak to, is that we are just so different from other kinds of financial institutions in terms of how our liabilities are structured. Our assets as well, to a degree, but most importantly our liabilities. So many of our contracts are structured for long-term performance, and they typically have provisions that incent the policyholder to maintain them and hold them for the long term; they typically aren't very valuable unless you hold them for the long term. This makes our business very different from deposit-driven businesses like the banking system.

I'm sure there's not an insurance company in the country that wasn't feeling tremendous stress during the crisis. There were great concerns about liquidity, about policyholder behavior—whether people would start surrendering annuity contracts and just accept surrender charges and so on. And it honestly didn't happen. Our company amassed a huge war chest of liquidity just to be able to withstand any sort of "run on the bank" scenario that might occur, as did most companies, and we didn't have any trouble doing that.

So I think it's really a lesson learned that is going to have to be retaught to the world as we go through regulatory reform—how different we are in many respects from banks.

A second lesson learned during that period, and I learned it firsthand, is how important the relationships were and are between insurance companies and regulators. I think one of the untold stories, or maybe one of the underappreciated stories of the financial crisis, is how responsibly and how well so many state insurance departments responded to the short-term needs of their regulated companies.

And I think that it's just more feasible to do that within our system than it is within the federal system, because in the case of the states with which Protective has its principal domiciliary relationships, which are Tennessee and Nebraska, we have frequent contact with our regulators—we have total transparency.

> **Our solvency rules are tested and work well. And it's really dangerous when you start trying to apply rules adopted for other systems to an industry for which they don't fit very well.**

We're communicating all the time, in real time sometimes, about what's going on with our company. There's a certain amount of trust that the regulator is getting the true facts and they know the situation, and I think that's generally true of our industry. And it enabled regulators to make some good decisions about giving us a little more benefit for things like deferred taxes, which really have value, and at least to a degree should be included in surplus. Some states provided some short-term solutions for things like redundant reserve financing through captive structures and other mechanisms, which made a lot of sense at the time.

The regulators never lost their focus on the solvency of the companies, but they also realized that there needed to be a little give-and-take in a time of stress.

Another way of saying that is to say that the process was not heavily politicized. There wasn't somebody running for office and beating up on insurance companies to get an edge against their political opponent. It was all very principled, with a problem-solving focus. I think you saw the opposite of that in Washington during the financial crisis. The discussions and debates around Dodd-Frank and the TARP program and all the various bailout programs were extremely politicized and extremely partisan. And I think the strength of our industry was the more businesslike approach to regulation that prevailed. Most companies probably would have muddled through, but I think that helped a lot to shore up the industry and give people confidence we were going to get to the other side of the crisis.

Gallanis: *In so many walks of life we seem to forget the lessons of history. Almost everyone forgot that this was not the first bad financial crisis that we've gone through. And interestingly, the NAIC's CEO, Terri Vaughan, has just published a paper with the Geneva Association that spends some time exploring the history of the life insurance industry in the Great Depression back in the 1930s, and she noted the same story then that you just described regarding 2008 to 2009—there had been an expectation of runs on the bank and massive company failures and so forth. But then, as in the recent crisis, the life insurance industry really came through very well, and the reason people were surprised is that they underappreciated the facts you just described. The nature of the liabilities of life companies is that they're stickier and they're different from the liabilities of other types of financial institutions, and they're not as susceptible to runs.*

Johns: Another important lesson is that the solvency rules for insurance companies were stress-tested and proved to work very well. For example, I think the risk-based capital model that our industry follows proved to be much more supportive and predictive of solvency than the risk-based capital model the banks followed. They're different models, and they're based on different premises.

I think it also made a huge difference that under statutory accounting there's not nearly as much emphasis on mark-to-market, short-term "fair value" accounting. If you had forced the whole industry to reduce surplus based on just temporary short-term mark-to-market of investment portfolios, the financial strength of the industry would have appeared much weaker than it actually was. And I'll come back to that theme over and over again. Our solvency rules are tested and work well. And it's really dangerous when you start trying to apply rules adopted for other systems to an industry for which they don't fit very well.

Gallanis: *This may not be as critical an issue for your company as it is for companies that are somewhat more active in the international sphere, but there's been a lot of discussion recently about efforts to move in the direction of international regulation—standardized international accounting systems, the so-called Solvency II approach, and the possibility that there may be a convergence of regulatory approaches and philosophies between the U.S. and Europe and the broader world. Going back to your point about the importance of not having accounting rules that artificially distort the economic strength of life insurance companies, how concerned are you about some of these developments possibly moving U.S. insurance regulation in a direction that's a little closer to the way that other countries do it for insurers (or that other regulations do it for other types of financial institutions)?*

Johns: Our company is not engaged in international life insurance business, so I'm more of an observer than a participant in those discussions. Although by virtue of serving on the executive

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Europe has not done a great job of managing its own house over the last decade. Why do we need to turn to them for a new way to manage our house and our financial system?

committee and the board of the ACLI, I'm certainly privy to a lot of the conversations that are going on.

I think it's difficult to overstate how important it is that we be very thoughtful in any sort of convergence process with other systems. It seems all the discussions have something in common, which is the United States moving toward systems that have been developed by the Europeans: Solvency II is very prominent right now.

The European systems are very different, but one of the similarities is a very strong emphasis on what they would call market-consistent valuation of assets and liabilities. It's another way of saying fair value accounting, except it doesn't really use market values all the time. There aren't any market values for a lot of the liabilities we deal with, so you have to discount things and come up with "guesstimates" as to what things are worth.

But what I hear from my friends who manage U.S. subsidiaries of European or UK companies is that it's going to be just devastating to them. You're going to have to carry extremely large levels of redundant surplus to be able to ensure your solvency, based on normal market fluctuations. Interest rates go up and down. Right now, we don't worry about that too much. Normal interest rate fluctuations aren't driving changes in surplus very much on our balance sheets, but under Solvency II they're huge.

And so you're seeing ING spinning off its U.S. life business in an IPO that's been around now for a couple of years, and hopefully it will happen one day. There are all sorts of rumors about European companies divesting themselves of their U.S. operations because they just can't handle the surplus stresses that will come from our spread businesses—primarily fixed annuities or universal life products that have spread income in the equation.

You know, maybe this is a little bit superficial to say, but Europe has not done a great job of managing its own house over the last decade. Why do we need to turn to them for a new way to manage our house and our financial system? I'm very concerned about that; again, the general theme is to question a movement toward breaking away from a system and a set of principles that have worked very well for a long time.

I think people don't understand how interrelated all of these things are. Again, we could have a long philosophical discussion about how well the guaranty system has worked, but if we start changing the rules around accounting and statutory accounting and mark-to-market accounting, we're going to put more stress on the system. And for what? The system has worked. If it's not broken, why do we want to fix it?

Gallanis: *How concerned are you about the general continuing depressed economic environment and the possibility that it could be exacerbated by what they're calling the "fiscal cliff"—where if Congress doesn't come up with a deal on spending and revenues this fall, there would be sequestration on spending programs and restoration of the early 1990s tax rate schedule? And do you expect Congress to cut a deal, a "grand bargain" as they refer to it, on spending and revenue issues?*

Johns: You asked a number of good questions. I think there's no question that the low interest rate environment is an enormous challenge for the life insurance industry. The industry was not built around the assumption that the 10-year treasury could be less than 1.5%. And whether you're a stock company or a mutual company, it doesn't really matter. We all face the same challenges. I think the good news is that, I believe, most of our companies have done a good job of managing their asset-liability relation-

ship, and so we're pretty well invested for the next few years. But as the reinvestment process goes on, it's going to erode margins and profits and put more pressure on product pricing, and that could be a real problem for the industry over the long haul.

In terms of the challenges in the economy, I personally think that the fiscal cliff issue will be addressed in some way that will entail a bipartisan compromise. And I say that because it must be; it just must be. Congress is not very good right now at coming to compromise and reasonable middle positions unless it has to, but I think it has to because of the consequences of not doing anything and letting the budget continue to soar out of control—and at the same time allowing all of the Bush tax cuts to expire, combined with the increased tax burden from the Affordable Care Act, combined with the fact they're going to need to pass another budget resolution to increase the debt ceiling. If they don't address all of that, I think they'll fear they won't be reelected in the next cycle, and so I think they will act.

What it will look like, I don't know. There's a lot of worry in our industry that some of the tax benefits that are foundational to our products—inside buildup, deferral of tax free annuities—might be on the table in that debate, and I suspect they will be. They already are. And how that will all play out, I don't know.

I can tell you that the ACLI and the industry are gearing up for a massive effort to try to protect our industry and explain why the tax benefits we're talking about are not our tax benefits—they are consumer tax benefits, which are very important to addressing some fundamental needs of the country, like retirement savings. We have a crisis coming. There's a saying, "If you're not at the table, you're on the menu" I think it's true, and so we're trying to be at the table.

Gallanis: *We'll be talking a little bit more about financial regulatory reform during this seminar, and we have seen a lot of efforts toward improving the way financial services entities are regulated. With so much national focus on Washington, there hasn't been enough attention paid to what's been happening at the state level. Over the past few years, commissioners at the NAIC have been working very hard on a number of things, including the solvency modernization initiative and revamping laws and processes for overseeing insurance holding company groups, particularly with a view toward enterprise risk and improved corporate governance. Do you have any observations on whether the NAIC is on the right track in those efforts, and whether there are particular things that you'd either like to see happen that aren't happening, or where you'd like to see a degree of particular caution exercised?*

Johns: If I may, let me address that at a slightly higher level, and then maybe get down to group supervision. I've been in the industry about 20 years, and I've been a CFO. I've run sales and investments and internal audit and risk. I've been active in the ACLI now for about a decade. And at my age, I'm probably not going to be here long enough to see how this really plays out. But observing all this, a couple of broad concepts stand out.

I think the NAIC now is facing some big challenges, in that it has a structure that was not designed to address the challenges of today. It's a state-based system of 51 very able insurance departments, led by very good people, but the system isn't constructed to deal with international issues very effectively. It isn't organized in a way to play a role in mediation with Washington, and it's not really structured very well to regulate complicated corporate structures like holding companies with multiple subsidiary structures.

It's not for lack of good faith or good effort or intention—it's structural. The organization is awkwardly postured within this new world we're living in. It wasn't built for this. It was built for a time when most companies like ours did most of our business in one or two states, and there wasn't a whole lot of interstate commerce in life insurance.

But I think there are some real opportunities for the NAIC to very constructively and productively deal with all these issues, and I suspect they will. I think first of all, you have to accept that no matter how you define the NAIC—and it defines itself as a standard setting organization, which I think is fine—increasingly it's going to be a regulatory body. If principle-based reserving goes forward, the standard valuation law will be fundamentally changed in a way that will authorize a group of commissioners to raise reserves or lower reserves for everybody in the industry. That's essentially a regulatory function.

So I think it's got to focus on acting more like a proper regulator; you know, more due process around what goes on, and a little more transparency and a lot more governance around the

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Our business is not thriving. I actually heard the CFO of one of the great companies in the country say, "You know, I'm very concerned this is a dying business, I hate to say it."

structure. I don't think that's just something for the benefit of the industry; that's also something that should immensely benefit the regulatory community. The more of that you have, the more credible and defensible you are when people question what you do. If you can just lay your cards on the table and say, "We have this great process we follow, it's fair and it's open." I think you're a much stronger and better organization if you do that. So that's just one man's thought in terms of the direction this whole world is going.

Group supervision is a good example of that. The NAIC's not really set up very well for group supervision. I think they're making some good steps in that direction. I think FIO will have an interesting role to play in that down the road.

Gallanis: *We think of the regulatory world as something that is exclusively the province of the insurance commissioners, with now some space for regulatory oversight in Washington under Dodd-Frank. But especially during the past decade a phenomenon has developed where issues having to do with consumer rights in insurance that one would normally expect to be addressed within the regulatory arena are being addressed outside of regulation—either by parties like state attorneys general or by plaintiffs' lawyers in class-action lawsuits.*

For example, the hot topic today is the unpaid death benefits issue, which has been the focus of a lot of litigation and other action by folks in government, some well outside of the insurance regulatory offices. A couple of years ago, we had the retained-asset accounts issue, and before that, similar efforts by non-regulators to, in effect, regulate in areas like broker compensation or policy sales illustrations or small-face-amount contracts and the like. From a company perspective, what are the problems associated with quasi-regulatory pressures or risks or costs that come at a company like yours from someplace other than the traditional insurance regulatory framework?

Johns: Well, Peter, I think everyone would agree this is an enormous problem. The unclaimed property issue is a great example of why what you call "quasi-regulation" is such a headache for the industry. I guess everyone knows that it's been discovered that a lot of insurance companies will check the Social Security Death Database to determine whether or not a life-certain annuity needs to be terminated because the policyholder has died, but they historically have not done that with life insurance policies—even though they conceivably could. But the theory is that people are pretty efficient in presenting death claims—99% of the time they do—but people frequently will not tell you someone's passed away and to stop sending the annuity checks.

Three large companies in our industry have entered into settlements in which they've agreed to very substantial fines or penalties. They've also agreed to procedures for how they will check the master file periodically. But it's created, potentially, regulation by lawsuit settlement. And if that becomes the standard, it's just a nightmare for companies. You may think it's simple, but it really isn't. How often do you check? Every day, every week, every month, every year? How much benefit comes from your effort? It's extremely expensive, depending on how you check, what you check, and how often you check. We now have three states that have very different requirements. There are different check periods now in the statutes of three states. And so we, the industry, the ACLI, are just crying out for a regulatory solution to this—for uniformity. Just give us one set of rules, and we'll live with it.

What we're hearing back from the regulatory community is, "No, we don't want to interfere with the process of adjudication of these unclaimed property claims." And of course there is a whole group of the tort bar that is rising up and saying. "This is a great opportunity for us." But it's a great opportunity for the NAIC to be at its best and provide a very firm and principled guidance on how this should be done for the benefit of consumers. Not us, not the companies, but consumers. But it's an enormous problem, Peter, and it's one that seems to be growing, and we really would like to see some help from the regulatory community on it.

Gallanis: *In addition to your work at the ACLI—you're scheduled to become chair of the ACLI board the year after next—you've been active in the Financial Services Roundtable. Could you tell us a little bit about what that is? In particular, I'd be interested in your perspectives on what insights being a member of a group like that, as opposed to ACLI, provides about regulation affecting the insurance industry.*

Johns: The Roundtable is a great organization. It's limited to 100 financial institutions, but by design it's very diverse. It has about a dozen life insurance companies, 10 or so property and casualty companies, and half a dozen asset management companies. It's got consumer credit companies, regional broker-dealers, wire houses, commercial banks, big investment banks—it's kind of a cross-section. It's got institutions smaller than we are,

and we're on the small side of the spectrum, and it includes J.P. Morgan and Bank of America as well. For me, it's been fascinating just to take a deeper dive into the world of bank regulation and to watch the Dodd-Frank legislative process and see how the banks handled that and what the outcome was and so on.

It's also interesting to observe just a different kind of prudential regulation: how it affects them, how their capital models work. They've just all gone through this CCAR process that MetLife got caught up in. It's a very interesting and very different process for how you look to your solvency and stress scenarios.

But I think it's also demonstrated that there are some commonalities in terms of the various business models, and consumer protection is increasing in interest. Most financial institutions are under the jurisdiction of the Consumer Financial Protection Bureau, and of course our life insurance industry is not. We were carved out of it, I think in part because it was recognized that our state system does a pretty good job of taking care of consumers, which again I think is a strength of the system.

But what it's done for a lot of insurance people, including life insurance people like me, has been to make us really rethink this whole notion of the optional federal charter. Our company and the ACLI were pushing really hard on that before the financial crisis. But I don't think there is a consensus today within the ACLI that it's the direction people really want to go, because there's so much concern that it wouldn't be optional and that the people who would regulate you—not at the FIO, but at the Fed or wherever insurance ended up—would take too long to understand how the insurance business works. And just the logistics of setting up a federal insurance department—a full-blown, fully staffed insurance department—are mind-boggling in terms of the time and effort, money, budgets, and so on.

So I think, while there's still a lot of sentiment for the optional federal charter, I don't think there's a clear consensus. Watching parallel developments in the regulation of other financial institutions through the crisis has provided a sobering perspective. It may be federal regulation isn't the best solution.

Gallanis: *When you spend time with your colleagues from other parts of the financial services sector at the Financial Services Roundtable, what do you hear about issues relating to Dodd-Frank and federal financial services regulatory reform that causes some of the folks from those other sectors to say sincerely that it's made their lives or their ability to serve their consumers harder?.*

Johns: I think the way banks are regulated is quite different from the way insurance companies are regulated, and in many respects the rules are different, as we all know. But I think even the relationship with the regulator is different. I understand that most of the larger banks have resident regulators that just live there in-house.

And if they want to distribute a board committee booklet of some sort to the risk committee, that goes through a process of regulatory review. It's a much more intrusive kind of regulation, and you can argue that it needs to be, because that system didn't perform very well in the crisis. But I think there's a view that it's gotten so much into the detail of the business—almost like a utility regulatory model—that it's becoming counterproductive and really interfering with the ability of banks to serve customers the way they would like to.

Gallanis: *A gentleman who once served as the chair of the NOLHGA board, Ron Downing, used to say that everything we do in the insurance industry and in the guaranty system always has to be done with the best interests of the insurance consumer front and center in all of our thoughts. In that vein, are insurance consumers, in your opinion, getting from the life industry and from the guaranty system what they need and what they deserve? And if not, what do you think we should improve?*

Johns: That's a great question. I really think the one thing I'll carry into retirement—it may be with regret—is that my colleagues and I have not been outspoken enough about that very point, about what the real focus of this industry should be over time. I think we have spent too much of our time on things that aren't helpful and valuable to the consumer and not enough time on the consumer-helpful issues.

Let me answer the easy question first. The guaranty system is functioning just fine right now. We have had our problems with Executive Life of New York, and I think with industry and association cooperation, we'll get through that in a way that I think, under the circumstances, is an optimal outcome for the consumers that are affected by it.

The Federal Reserve, as you know, has a dual mandate—optimizing employment and controlling inflation. And I strongly believe that our industry should also have a dual mandate. If you carefully read state insurance law statutes, you can see it really is there. It's both solvency and consumer protection and benefit, and they're interlinked. Clearly, ensuring solvency is first and forever in the consumer interest. No consumer wants to find out one day that their insurance company is insolvent and they don't have the benefit they have paid for and depended on.

They rightfully expect it. But I think we've overloaded the equation so much on the side of solvency and capital redundancy and so on that we've lost sight of another crucial consumer interest, which is having a product they can afford and that they want to buy.

Again, sometimes I'm amazed that in the regulatory discussions we have, we don't sit back and take a macro look at the life industry. It is not an industry that is currently doing very well. It is not an industry, in my opinion, that is really serving the middle-income American consumer very well. The stock market valuations on life companies are at all-time, or at least 20- or 30-year, lows. Most life insurance companies that are public companies are trading at less than their GAAP book value: an indication that they're not performing well financially. Companies like Hartford, one of the great companies in the industry, just quit selling life insurance and annuities—just gave it up. They've been doing that for 200 years, and they just quit. They insured both Robert E. Lee and Abraham Lincoln; now that's hedging, you know?

Sun Life of Canada just pulled out of the United States. A lot of big companies out there are just a shadow of their former selves. If you look at the really big companies like Met and Pru

But the view now I think at the ACLI is that we are moving into a hybrid system—that we are going to have some level of federal regulation of the industry and some level of state regulation.

and read their investor presentations, they're talking about how much money they're investing outside the United States in basic life and annuity pension-type businesses. Our business is not thriving. I actually heard the CFO of one of the great companies in the country say, "You know, I'm very concerned this is a dying business, I hate to say it."

If you look at sales trends, the penetration of family ownership of individual life insurance is the lowest it's been in 50 years. The share of annuities in the overall retirement savings pie is static to declining against 401(k)s and mutual funds and other things that people are buying to save for retirement.

So I think you can make a good argument that if you think our primary mission is to get these valuable products out there to protect families, protect people, from dying too soon or being broke when they retire, we're not doing a very good job of it. But we spend a huge amount of time talking about how redundant a reserve should be. And I think it's important that reserves be somewhat redundant, but at some point redundant reserves get to be so expensive and so cumbersome and so complicated to finance, that you've turned the whole system upside down in terms of what you're trying to do.

One thing I think we need to focus on in the dialog between the industry and our friends in the regulatory community is on what is really in the consumer interest. We're getting away from what we should be doing. We should have this dual mandate of solvency and taking care of people—their needs, their families—but I think we're only zeroing in on that one slice of the solvency piece and not thinking about the consequences of that across the whole spectrum of what we do. I think that's one of the reasons this industry is struggling so much on PBR, AG 38, and related issues.

To be sure, interest rates are low, everybody's worried about Europe. That certainly all plays into our thinking—but we've lost sight of that core mission of taking care of widows and orphans. You go to a Million Dollar Roundtable meeting and you'll hear the most inspiring speeches about how noble what we do really is. We take care of that couple that has one breadwinner and two children when the breadwinner dies. And then you go trail around with one of the great producers, and what do they do? They often go meet with multi-millionaires and try to figure out how to craft a customized variable annuity in some offshore tax shelter.

And that's going to get us on the tax reform issues too. They call them "tax preferences"—they're really not very well distributed among the population. I think it's because we've made the products too expensive and too complicated and really too hard even for us to sell, and that's why we've got to broaden the discussion.

Audience Question: *I was intrigued and alarmed by the comment that you quoted from someone else about a dying industry. Is that a thought that's being thought by many people these days?*

Johns: I don't think that's a consensus view at all. I think there's still a lot of energy and enthusiasm around how we get our momentum back, and that's probably a "dark of night" kind of worry. But I think there is some concern about the real future of the life insurance industry. You know, what do we do? Where do we fit into this whole scheme of things that's out there?

And the growth and profitability are things that really are daunting people right now. How are you going to grow next year? If you look at Wall Street estimates, they're not forecasting a lot of growth. We have to be a dynamic industry if we're going to attract capital to fund our future. I don't think people are close to giving up yet, but I think they worry a lot about it.

Audience Question: *You said that perhaps a federal charter was not the answer for a lot of companies. And I think you also said that the state system faces some challenges in regulating groups and with the international regulation that's coming on. Any suggestions on how we can preserve the state system and strengthen it even further than has been done in the last decade?*

Johns: I've had the privilege of serving the last four or five years as chair of a subcommittee of the ACLI board, which is the Financial Services Steering Committee, and regulatory reform is one of our topics. So we spent a lot of time on OFC when that was in the forefront.

But the view now I think at the ACLI is that we are moving into a hybrid system—that we are going to have some level of federal regulation of the industry and some level of state regulation. Predominantly state regulation. And the FIO, that's a very interesting development. I think there's a lot of enthusiasm in the industry for FIO. I know Director McRaith is highly respected

throughout the industry. He's a very smart guy, he knows the business, and he's very open.

But I think there are a couple of models that now have attracted some attention, and one is to increasingly look at the NAIC as a regulator; it's moving that way. Make it more of a national regulator of insurance. Create a statutory framework around which that happens. There are all kinds of issues associated with it.

Another is more of a hybrid model—moving in a direction for FIO to actually set a national standard of rules. It could be the NAIC model laws; you could just take that as a set of rules and then let FIO designate some states to be national insurance regulators. So you've got the FIO stamp of approval if you're consistent with a very high standard of rules.

And maybe not every rule; maybe just the important ones, just solvency, accounting, product approval, agent licensing, and you could decide what you want to do about consumer protection. And then MetLife could say, "Look, the state of New York has been designated by FIO as a national insurance regulator; If I get a license from them, I can go to the other 49 states and do business without having to file products everywhere and go through all that rigmarole and be examined all the time." Again, it would be a very different system, but it would still be state-based. It would be optional; states could get in or out. Companies that are in a few states could just say, "I don't want to be a part of that; I like what I have." It would not necessitate building a big federal insurance department, and yet you'd create a very cohesive national system for companies that wanted to be regulated that way.

That's just a model, you know, but I think it's an interesting one that might keep the state system strong and where it is, but also give companies a lot more efficiency if they want to have a national focus. ✯

NOLHGA Calendar of Events

2012

October 1–2	**MPC Meeting** **San Antonio, Texas**
October 2–3	**NOLHGA's 29th Annual Meeting** **San Antonio, Texas**
October 21–23	ACLI Annual Conference Washington, D.C.
November 29– December 2	NAIC Fall National Meeting Washington, D.C.

2013

January 8–10	**MPC Meeting** **Clearwater, Florida**
April 6–9	NAIC Spring National Meeting Houston, Texas
April 9–10	**MPC Meeting** **Salt Lake City, Utah**
July 9–10	**MPC Meeting** **Chicago, Illinois**
July 11–12	**NOLHGA's 21st Legal Seminar** **Chicago, Illinois**

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