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New York State of Mind

NY Liquidation Bureau chief Mark Peters discusses the ELNY situation and the steps he's taken to restore confidence in the Bureau

Mark G. Peters became Special Deputy Superintendent in charge of the New York Liquidation Bureau (NYLB) on April 2, 2007. One of the first challenges he faced in taking over the Bureau was its handling of the Executive Life of New York (ELNY) rehabilitation. The Bureau, which had overseen ELNY's operations and its payments to thousands of structured settlement policyholders since 1991, had failed to report a significant shortfall in ELNY's asset/liability balance that first became apparent several years before Peters took office. On December 4, 2007, New York Governor Eliot Spitzer announced what he described as an "agreement in principle" involving the Liquidation Bureau, the life insurance industry, and various property/casualty insurers to provide the funds needed for ELNY to meet its obligations.

Mr. Peters spoke with the NOLHGA Journal in late 2007 to discuss the progress the Bureau has made in the ELNY matter as well as his attempts to reform the Bureau.

What were some of the challenges you faced in taking over the NYLB?

We had to confront a variety of challenges. We learned that we needed to do a better job than we'd been doing in the past in moving estates along, collecting reinsurance, paying distributions, getting estates closed—which is, of course, our core function.

There were certain estates that



Mark G.
Peters

required immediate attention, such as ELNY, where we learned there was a significant deficit that was threatening our ability to make payments to accident victims and pensioners who depended on those payments. So in addition to the overall challenge of moving estates along more quickly than we had in the past, we also had the specific challenge of fixing the ELNY deficit so we could guarantee that the roughly 11,000 accident victims and pensioners would not have their financial lifelines threatened.

What was the public perception of the NYLB when you took charge?

You have to remember that when I took over the Bureau early in 2007, my predecessor had been indicted the prior year for corruption charges, and that clearly colored the perception of the Liquidation Bureau.

I think there was a feeling that there was a need for us to move more quickly

on estates—get the assets marshaled, payments made, and estates closed down. And while there were huge numbers of very talented people working here, there was a real need for leadership at the top to let those people do the best job they could.

Has there been a lot of turnover since you arrived?

When I got here, because of the indictment, there was virtually no senior staff

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Protecting the Future: Lessons from Our Veterans

The following is adapted from the President's Address given at NOLHGA's 24th Annual Meeting in October 2007.

This is the ninth time I've appeared before you to deliver the annual NOLHGA President's Address. Some years ago, my friend Bob Ewald told me that this speech is supposed to serve, in part, as our annual "state of the organization" report. I am pleased to be able to report to you that the state of this organization remains strong. We have formed two new insolvency task forces in 2007, and a number of others have carried on some very important work begun in prior years. The work of our task forces and committees has been effective, productive, and valuable in protecting the insurance consumers in your states, who are the reason for the existence of our individual member guaranty associations and of NOLHGA.

The state of the organization is strong precisely because so many in this room—and those who came before them—have worked so very hard to make sure that consumers have received the protection they are entitled to expect from us. However, as has often been said, we are only one bad *New York Times* story, or one bad *60 Minutes* episode, away from losing much of the goodwill that we have all worked so hard to earn.

In the spirit of candor, I must share with you a confession: I have never once in my life had an original idea, and I probably never will. However, I have been blessed to have the opportunity to work with some highly creative, effective people, from whom I've tried to borrow every bit of knowledge I could get. And the important thing about borrowing and building upon the good thinking of other people is that it's not hard to do, if we just take the time to listen.

About 10 days ago, Bob Ewald sent me a note about the new Ken Burns documentary on World War II, praising the extent to which Burns—unlike a lot of other filmmakers—got the narrative right by letting the people who lived through the war tell their own stories. It's critically important that Burns has done this, because the day will come all too soon when we won't be able to go to those veterans for their direct accounts; we won't be able to ask them our questions and hear their answers.

There is an odd problem for our system that stems from not having been challenged by a new, major insolvency for some time. The fact that we haven't been so challenged is, of course, from society's standpoint, a very good thing. But for our organization, there are adverse consequences of spending too long a period without facing the tough questions of how best to protect consumers in a large, complex, national insolvency.

For one thing, when our energy isn't directed toward our principal purpose—protecting consumers—it's too easy to redirect the energy to less important, even counter-productive, areas. More important, we can also lose some perspective about the primacy of consumer protection when we aren't constantly being stretched to achieve that goal.

So bearing in mind what Ken Burns accomplished by capturing, while it's still possible, the wisdom of those who experienced World War II, I've made an effort recently to boil down to succinct maxims some of the most important lessons I've learned from some leaders of our system. Though I've learned from many more people than are on this list, and though these snippets probably aren't even the most important things each of these people taught me, here are some things I've taken away from my experiences with the NOLHGA Board Chairs and MPC Chairs with whom I have been privileged to work:

From former NOLHGA Board Chair Doug Goto: *Be Decisive*. Waffling never helped to solve any problem, and deferring a decision is in reality just another decision—usually the wrong decision.

From Doug's successor as Chair, Bill Fisher: *Always Remember the "People" Aspect of Every Challenge*. No human controversy can be resolved without recalling that it has an important emotional component.

Former MPC Chair Peggy Parker taught me that *steady effort* toward improvement is usually more effective than trying to effect change by sudden shifts.

Board Chair Roger Harbin persuaded me that we must always *obtain and understand the information* that is critical to a particular choice.

I learned from Board Chair Dave McMahon that this organ-

In the dozens and dozens of multi-state insolvencies where task forces have developed resolution plans—insolvencies of all types, sizes, and locations—the affected states have almost unanimously chosen to participate in the resolution plans developed by their task forces.

ization is strongest when we develop a well-reasoned, widely accepted *consensus*.

Former MPC Chair William Falck taught me that our system contains a wide variety of *different and valid perspectives*, each one of which is fully entitled to respect.

From Board Chair Tom Potter I derived the lesson that, for NOLHGA to be respected as an institution, it has to be clear to others that we operate as a *rational business enterprise*.

Tom's successor as Board Chair, Jim Mumford, lives by the maxim that *even a good organization can never stop trying to improve*.

And William's successor as MPC Chair, Jack Falkenbach, convinced me that *attention to detail always pays dividends*.

Merle Pederson, another NOLHGA Board Chair, held that we should *run the organization as though strangers are watching us—because they are*.

Our current MPC Chair, Bart Boles, persuaded me of his position that *it's impossible to learn too much, too early* about a company that's in serious financial difficulty.

And from our current NOLHGA Board Chair, Chris Chandler, I've learned that our greatest organizational asset is our ability to function as a motivated *team*.

Collective Action

What was most heartening about distilling those precepts from our distinguished system leaders was the extent to which their views are virtually hard-coded into the operations and customs of NOLHGA.

Viewed objectively, the mission we are asked to perform through the guaranty associations' vehicle, NOLHGA, is inherently quite difficult. When an insurer doing business in many states fails, we are expected to devise a unified solution protecting consumers across the country, almost always in very short order; under intense pressure; and in the face of a complex array of factual, legal, financial, political, and technical challenges. To do that, we must devise resolution plans reasonably acceptable to as many as 52 separate and independent guaranty associations, each operating under its own statute; each governed by its own board and overseen by its own state insurance commissioner; and each having its own set of policies, preferences, and priorities.

Put another way, every time the fire bell rings for us, we are confronted by a new, unique, and critical—but classic—problem of *collective action*. And each time that has happened, over a period of roughly 25 years, we have risen to the occasion,

answered the challenge, and delivered on our obligations to the insurance consumer.

In one way, that's nearly miraculous. You could ask the question of almost any other membership organization—could that organization respond as quickly and comprehensively to a long series of complex challenges and achieve nearly unanimous member buy-in, over and over again, every time a critical situation presents itself? Could the NAIC do that? Could the ACLI? Could NCIGF? I say that not to disparage any of those terrific organizations, but simply to highlight just how effectively, over the years, we have accomplished our goals through the mechanism of NOLHGA.

Since not everyone in this audience has lived through the experience of a major insolvency from within the guaranty system, it might be worth taking a moment to describe briefly *how* we respond to a multi-state insolvency situation.

NOLHGA's organic documents provide that the "Members' Participation Council" for an insolvency comprises the guaranty associations of all the potentially affected states. From among those associations, the MPC Chair selects an Insolvency Task Force—representatives of a subset of states who have, collectively, substantial experience in insolvency cases and who are fairly representative of all affected state associations. The task force is led by a Task Force Chair, also appointed by the MPC Chair. The Task Force Chair is usually a guaranty association Executive Director with substantial case experience—for example, Jack Falkenbach of Delaware, Mike Marchman of Georgia, or Frank Gartland of Ohio, just to name three of the most recently appointed Task Force Chairs.

The task force, served by a team of insolvency professionals appointed by the NOLHGA President with the concurrence of the Task Force and MPC Chairs, gathers the facts relating to the situation, analyzes issues, develops potential response plans, and ultimately recommends a course of action—a resolution plan—to all of the affected states. Those states are given a period of time in which to decide whether to participate in the plan developed by the task force or instead to respond to the insolvency independently by meeting their statutory obligations to persons whom they cover directly, outside of the resolution plan.

And here's the amazing thing, the extraordinary collective action result: In the dozens and dozens of multi-state insolvencies where task forces have developed resolution plans—insolvencies of all types, sizes, and locations—the affected states have

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Insolvency

The nation's guaranty system experts head to Amelia Island for NOLHGA's 24th Annual Meeting

By Sean M. McKenna

All meeting photos by Kenneth L. Bullock

Looking out on the audience gathered at NOLHGA's 24th Annual Meeting in October 2007, NOLHGA President Peter Gallanis observed that "experience with life and health insolvencies is almost entirely held by the people in this room." That experience was matched only by the dedication of the attendees, who eschewed the charms of beautiful Amelia Island, Florida, and instead spent their time discussing issues such as the health-care crisis, changes in the insurance market, challenges for the investment portfolios of some of the major players in the industry, and the U.S. Treasury's analysis of insurance regulation and the state-based guaranty association system.

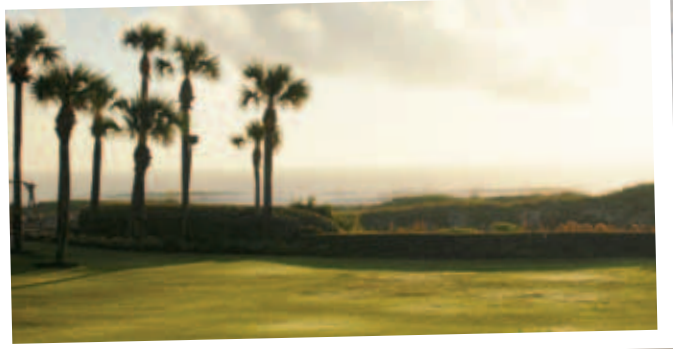
At the meeting's end, the attendees headed home, perhaps the only group to leave Florida less tan than when they arrived. That's dedication.

DC Comes to FL

In a speech that also touched on troubles in the housing market and the renewal of TRIA, David Nason, assistant secretary for financial institutions for the Treasury Department, described the department's ongoing review of the country's financial services regulatory system.

The review, he said, is designed to "improve efficiency, reduce overlap, strengthen consumer and investor protection, and ensure that financial institutions have the ability to adapt to constantly changing strategies and tools."

The insurance sector is a key part of this project,



Nason added, acknowledging that "many believe that the patchwork of a more-than-51-state regulatory system has led to market inefficiencies and that the insurance regulatory structure needs to be modernized to reflect the complexities of today's global marketplace." Proposals to modernize the system include total federal preemption, dual federal/state systems under an optional federal charter (OFC) approach, mandated standards for the state-based system, and harmonization and increased uniformity among the states.

Nason noted that both OFC bills in Congress have provisions to include the current state-based guaranty association system, and he praised the performance of the associations. "Clearly, guaranty funds play an important role in the insurance industry by providing a level of protection to policyholders, and they have provided this service well for many years," he said. "Further understanding and refining how the guaranty funds would operate under an OFC model is

important to evaluating the overall model. We look forward to continuing to evaluate this issue in the coming months."

Nason emphasized that the department is still performing its review and so hasn't taken an official



David Nason

Policy Island }

stance on any of the modernization proposals. He expects a report to be issued in early 2008.

State Challenges

While the federal government analyzes insurance regulation, many states are taking the lead in health-care reform, according to NAIC President and Kansas Insurance Commissioner Sandy Praeger. She noted that policymakers have been debating the issue of Americans without health insurance for more than 20 years, but as the numbers climb—the current estimate is approximately 44 million people—support for reform continues to grow. “We’ve got large companies calling for reform,” she said, as the cost of providing health insurance for their employees becomes a competitiveness issue.

According to Praeger, congressional and state reform proposals are focusing on a few components: individual mandates, direct subsidies, individual market reforms, purchasing pools, and reinsurance. All of them present difficulties. Mandating that all citizens have health insurance (which Massachusetts has done in its new health-care program) raises a key question: “How is the mandate enforced? Do you really want to get punitive” on citizens who fail to obtain insurance? Direct subsidies are part of almost every reform proposal, but they raise questions about who should receive the subsidies and which procedures should be subsidized.

There’s a great deal of debate over the best way to reform access and rating rules in the individual market, while one attempt at creating purchasing pools has already proven unsuccessful. “The association health plan concept is dead,” Praeger said,



Sandy Praeger

although there is strong bipartisan interest in creating multi-state purchasing pools for small businesses and the self-employed.

Praeger noted that the success of the Healthy NY plan, which provides government-funded reinsurance for the “excess” cost of certain high-cost, low-income persons, continues to spark interest in reinsurance. However, there are questions about how the government can be sure the payments made to the insurance plans will result in lower premiums and not just higher profits.

No major reforms are expected in the next few years, and Praeger stressed that the NAIC “will oppose plans that take away our ability to be there for the consumer.”

Consumer protection was also on the mind of Alex Sink, chief financial officer for the Florida Department of Financial Services. Her role, unique to Florida’s state government, combines the functions of comptroller, insurance commissioner (without the regulatory responsibilities), and other offices and has “a very strong education and advocacy function,” she said, noting that the department receives approximately 400,000 calls from consumers each year. “It’s a fabulous place to collect data on trends,” she added, which allows her department to approach the insurance division and request a market conduct exam when a troubling issue or trend is identified.



Alex Sink

Sink also spoke about her efforts to bring attention to the need to prepare for the risks of climate change, including its potential impact on the insurance industry. “You in the life and health industry

have some real challenges and have to put a lot of thought into how climate change will affect people's health," she said.

As CFO, Sink is one of four members of Florida's Financial Services Commission, which oversees the Office of Insurance Regulation and the Department of Financial Services. Commenting on the regulatory modernization debate that Nason touched on earlier in the meeting, Sink said that "I still can't get over the fact that national insurers have to go to 50 different places

to get products approved. It sounds bizarre to me."

Rep. Jerry Keen, the Republican majority leader of the Georgia State House of Representatives, took a different view, saying that federal regulation in any form is "usually more burdensome" than state regulation. He added that "the federalization of the insurance industry concerns me greatly" and stressed the need for the private sector to offer solutions to any problems affecting the industry.

Strategy, Communication

Highlight NOLHGA Chairs' Speeches

Outgoing NOLHGA Chair Chris Chandler and Incoming Chair Gene Choate both looked to the future in their addresses at NOLHGA's 24th Annual Meeting. Chandler spoke at length about the NOLHGA Board's 2007 strategic planning effort, noting that the Board concluded NOLHGA was striking the proper balance between insolvency management and insolvency support activities. The Board stressed, however, that "NOLHGA must stay focused on its core function—to assist the guaranty associations in the fulfillment of their statutory obligations."

The Board also suggested a number of initiatives, including increased education, more participation by NOLHGA staff in guaranty association meetings, publication of NOLHGA Board meeting minutes (which can be found in the "Committees" section of the NOLHGA Web site), and distribution of the management report prepared for quarterly Board meetings.

Chandler stressed the importance of trust as NOLHGA and its member associations work together to achieve their goals. "Lack of trust is like a cancer that weakens and ultimately kills the organism," he said. "If we put our collective goal ahead of our individual and state goals—if we put the team results ahead of our individual issues—then our teamwork will be a powerful force for our survival."

Choate also spoke of the keys to the guaranty system's survival. "Listen, talk, and improve," he said. "That's the surest path to success in any endeavor, and we in the guaranty community can do a better job in all three areas." Choate added that there's a perception that the Board is isolated from the membership—that it's not listening—and announced that there will be a concerted effort by Board members to make themselves more available to members. This will include inviting local state board members and administrators to attend quarterly Board meetings.



Gene Choate (left) and Chris Chandler

This and other efforts to listen, Choate said, will lead to the next step—"talking about where the guaranty system needs to go and how to get there." The Board began this process with its strategic planning effort, he noted, but "we need to hear your ideas as well."

The final step is improvement, and Choate cited a number of areas in which the system has already made strides, including analyzing new products and educating key figures on Capitol Hill on the workings of the guaranty system. More, however, needs to be done. "Chris has been preaching the gospel of uniformity and best practices during his tenure as NOLHGA chair, and that's a message you'll hear from me as well," he said. "We need to embrace transparency as we strive for ever-higher levels of professionalism in our operations. Our member companies and the policyholders who rely on us expect and deserve no less." ★

Investing & the International Market

The insurance industry was also well-represented on the meeting program, with Prudential Financial Vice Chairman Mark Grier giving his insights into international markets, regulatory structures, and the market shift to individual responsibility for retirement security. He noted that “the market is becoming a lot more similar” globally, a trend he called convergence rather than globalization. He added that “there’s a huge opportunity for the insurance industry” in emerging markets such as China and India, although many companies in North America and Europe still have their main focus on mature markets, including those two regions.



Mark Grier

Grier said that current regulatory initiatives are focused on privacy concerns (a huge issue in Japan), accounting issues, and consumer activism (primarily suitability, but also pricing, sales, etc.). “I can’t overstate the importance of the regulatory issues,” he said. “This is big for us.” In particular, he pointed to work being done on international financial reporting standards and establishing the “fair value” of assets and liabilities, which can be more difficult in the insurance industry than in other sectors of the financial services arena. “Our objective here has to be a level playing field,” he said, “and it’s not at all clear that’s the path we’re on.”

One path that is clear, Grier stressed, is that the market is shifting to address the growing needs of consumers to plan for their retirement income. As life expectancy increases and birth rates drop, “there are going to be fewer people working to support that group over 60,” he said. The shift to individual responsibility for retirement “is happening all over the world.” As a result, products are shifting to stress investment returns rather than coverage of mortality risk.

A different kind of risk was addressed by Rob Schimek, chief financial officer for AIG—Domestic Brokerage Group. Schimek explored the crisis in the U.S. residential mortgage



Best-selling author Randy Wayne White entertained attendees with a colorful speech that touched on his time as a fishing guide and his friendship with former baseball pitcher Bill Lee. White spoke of the value of storytelling as a way of holding on to our experiences, saying “words are our only anchor in what is an absolute rocket sled of life.”

market and its effect on the insurance industry by illustrating the effect it has had on AIG. He began by noting that “not every aspect of the residential mortgage market was created equal,” drawing a distinction between the prime and

subprime markets and stressing that there are distinctions within the subprime market as well.

AIG has approximately 10% of its assets in the mortgage market, and Schimek said that all insurance companies have at least some exposure to this market. The question, he said, is not whether a company has this exposure, but

rather how solid its investments in the mortgage market really are. More than 90% of AIG’s investments are rated AAA, which means the company’s risk from the crisis is lower than it appears. This only becomes apparent, however, when you dig a little. “Not all exposures will have equal effect,” Schimek said. “Look beyond what can you see today and say, ‘Tell me more about what I’m not seeing.’” ★

Sean M. McKenna is NOLHGA's director of communications.



Clearing the FAYWG

The NAIC's Financial Analysis Working Group has become a valuable tool in targeting troubled companies before rehabilitation or liquidation becomes necessary

By Randy Blumer



This is a story of people successfully working together to achieve what could not be done individually, using cooperation, collaboration, and communication. It is the story of a large group of people toiling, not for fame, glory, or self-promotion, but simply for the success of the endeavor. Perhaps that is the basis for the success.

The NAIC's Financial Analysis Working Group of the Financial Condition (E) Committee is the story. Affectionately called "FAWG," this group has quietly performed yeomen's work behind the scenes of the vast insurance industry and its regulatory community.

I was present at the inception of this worthy endeavor, and what follows are my recollections. For those who know me and have for years accused me of being in a fog (or FAWG)—how right you were.

The History of FAWG

Since the beginning of state-based insurance regulation, regulators have assisted each other in dealing with regulatory situations. Before the creation of FAWG, there were many examples of excellent regulatory outcomes enhanced by the cooperative efforts of state insurance regulators. In fact, some of those situations in the 1980s led to the formation of FAWG.

When a couple of noteworthy insurance groups with a countrywide market presence were experiencing significant financial and operational difficulty in the 1980s, regulatory leaders of the time put together groups of key regulators with a major stake in the situation to work together to seek solutions and interact with management of the insurance groups and other interested parties. The outcomes in most cases were far better than would have been achieved had each regulatory agency gone its own way in dealing with these complex situations.

What became apparent to regulatory leaders during these situations was that the abilities, experience, skills, tools, and will of state regulators varied tremendously. Some states had sufficient statutory authority and "tools of the trade," as well as staff knowledgeable and capable enough to engage a company's management and find solutions to the situation. Others lacked some of the necessary components.

A handful of experienced and knowledgeable regulators not only recognized this range of abilities but also set about to improve the regulatory community. The NAIC Troubled Insurance Company Handbook was one of the first products of this effort. The handbook was meant to provide guidance for commissioners and insurance department personnel in identifying troubled insurance companies, determining regulatory actions, developing insurance department procedures for discharging responsibilities with regard to these companies, and structuring and organizing an insurance department to achieve these objectives.

The same regulators identified a number of other areas for improvement. The origins of many major regulatory initiatives—such as the NAIC Financial Regulation Standards and

Accreditation Program, risk-based capital (RBC) standards, and various financial analysis solvency tools—have their roots in this initiative.

Back to the FAWG story. Sometime in the late 1980s, a group of regulators with significant experience in identifying troubled insurers and dealing with troubled insurance company situations was put together in a precursor to FAWG. I believe the group was originally called the Troubled Company Working Group, was later renamed the Potentially Troubled Company Working Group, and was eventually given its current name. The name changes were presumably meant to soften the sound or impact of being discussed by the working group. I'm quite sure the extraordinary American philosopher George Carlin has commented on such use and abuse of language.

At our first meeting, we sat around with piles of insurer annual statements, looking at each other and wondering what we should do next. Not having any selection criteria, we considered what options we had to best identify those insurers we should look at more closely and what we should do after identifying insurers that appeared to have some issues. Utilizing the old IRIS ratio system was of some benefit but ultimately proved to be inadequate for the complexity of the universe of insurers being evaluated.

Eventually we came to the conclusion that each member of the group was aware of insurers that had issues because we were either the domiciliary regulator or an insurer had such a significant market presence in our state that some level of analysis beyond the regular examination process was already being performed. From those primitive beginnings, a couple of things became obvious. We needed more-sophisticated analysis tools to make early identification possible, and we needed to establish a process for communication and interaction with the state of domicile and other states regarding those insurers for which regulatory intervention was needed.

Over time, FAWG set about developing its own analysis tools. Knowing data and data management would be a critical part of any analysis process, the NAIC had commenced the centralized collection of electronic financial statement data (so each state would not establish its own collection efforts). From this data, specific items were selected as important identifiers of the condition of an insurer and were measured against the universe of insurers to identify outliers. The benchmarks/identifiers for life and health insurers are generally in four categories: leverage, assets, liquidity, and operations.

Under leverage, some of the primary benchmarks include net change in capital and surplus, surplus relief ratio, and gross and net premiums to capital and surplus. For the asset category, high levels of affiliated investments or non-investment grade bonds; high levels of real estate, BA assets, or mortgages; maturity distribution of bonds; and comparable asset mix to industry averages are among the primary benchmarks.

The benchmarks for liquidity include declines in cash and invested assets, negative operating cash flows, high levels of surrender benefits and withdrawals, and (for annuity reserves)

assets available for withdrawal at book value without adjustment. Benchmarks for operations include material changes in net premiums (plus or minus), consecutive years of negative net income, a large drop in net income, and negative trends in investment yields.

These internal FAWG analysis tools proved over time to be very good at identifying potential problems. As regulators noted the successful early identification of insurer situations by FAWG, interest developed in how the group was able to come up with the information, and the group was asked to share its methods. The FAWG identification system eventually became an automated prioritization tool available to all regulators. The information and more in-depth analysis and discussion methods of the FAWG group were the seeds that

(defined by a combination of premium volume and writings in multiple states) insurers and insurance groups. The group also reviews companies or groups outside that scope if the need or desire arises.

When FAWG began, a single NAIC employee assisted the group. Today the NAIC's Financial Analysis Department (FAD) of the Financial Regulatory Services Division performs a major role in the group's activities. The FAD staff utilizes various financial analysis solvency tools to generate annual and quarterly analysis materials to assist the group in making determinations of those company situations that merit more in-depth analysis and involvement. The analysis performed by the FAD is truly state-of-the-art and matches or exceeds the levels performed by rating agencies and other financial market

From its humble beginnings, FAWG has become a far more sophisticated operation, fully utilizing all available information and data as well as the knowledge of highly skilled regulatory analysts and troubled company specialists from insurance departments across the country.

began the NAIC Financial Analysis Handbook, now widely used by regulators as a detailed, sophisticated tool for analyzing factors such as investments, loss reserves, reinsurance, and management practices.

The tools, methods, and processes of FAWG have morphed considerably through the years. However, the group's mission—identifying insurers with possible financial and operational difficulty and engaging domiciliary and other regulators to develop intervention strategies to correct the problems—has remained steadfast.

Today's FAWG

From its humble beginnings, FAWG has become a far more sophisticated operation, fully utilizing all available information and data as well as the knowledge of highly skilled regulatory analysts and troubled company specialists from insurance departments across the country. The current group consists of 16 people from 16 state insurance departments representing the four zones of the NAIC. Members are accepted only after a review of their experience and skills to ensure the group is made up of members who are among the best in the country in performing financial analysis and dealing with troubled company situations. To advise and assist state regulators in dealing with these situations, FAWG must have a membership that includes battle-tested regulators who know what to expect.

The group reviews vast amounts of analysis materials and provides leadership in the regulatory community in dealing with complex regulatory challenges for nationally significant

analysis organizations.

FAWG meets annually for several days to discuss the companies and groups identified from the initial levels of analysis as being outliers when compared with benchmarks of the industry market segment in which they compete. FAWG similarly reviews quarterly financial analysis data and information and holds lengthy teleconferences to discuss those results.

During its discussions, FAWG determines which situations merit communication from the group's chair to the insurance commissioner and key staff for the state of domicile of the insurer under review. The communications include a discussion and description of the specific issues identified, questions regarding the regulatory activity by the state, and suggestions or comments on possible regulatory intervention options. The group reviews the regulators' responses in detail to evaluate their understanding of the situation and their depth of response and involvement.

For certain situations, the insurance departments of the state or states of domicile for the insurers under review are asked to make presentations at the NAIC's next quarterly meeting. The purpose of these presentations is to share knowledge of the situation, facilitate discussion, and provide information to all state regulators. These meetings are open to all state insurance regulator members of the NAIC. The other FAWG meetings are closed discovery meetings, and only FAWG members may participate.

Special subgroups are often formed for certain insurers and groups to facilitate communications and strategies. Selected states serve as the lead regulator in the subgroups to facilitate

interaction with other interested states and take the lead in interactions with company management. The FAWG group itself does not meet with or interact directly with the insurer's management. The responsibility of engaging the company management falls to the domiciliary regulators and other involved states in those situations where subgroups are formed.

Many insurers and groups are regularly reviewed, discussed, and monitored by FAWG—sometimes for years—until the issues in question are resolved; the company is merged or acquired by a stronger entity, thus decreasing the concern; or the company is liquidated or in a runoff status and is no longer actively writing insurance.

A Success Story

FAWG has been a success story in a significant number of situations with insurers and insurer groups because the people involved have been willing to share their time, energy, and experiences in dealing with insurers with financial and operational difficulties. Rarely do regulatory interventions in these situations go smoothly. Seldom do the management and ownership of an insurer or group of insurers initially welcome the regulators' involvement in the situation. However, the most experienced and skilled regulators have developed methods

and approaches to produce positive outcomes that are to the benefit of the policyholders and public they are charged to protect and very often are beneficial to the insurer as well. In other words, this peer group of regulators aids not only the insurance regulatory community but also the insurance marketplace.

Is this a model worthy of being repeated in other scenarios? The NAIC believes so—the Market Analysis Working Group (MAWG) was created in recent years, replicating the FAWG approach in dealing with market conduct regulatory situations. Somewhat similar efforts are in place in the federal banking regulatory structure.

FAWG has provided an excellent forum for regulators to share their regulatory skills and knowledge. It has also aided in providing an approach for state insurance regulators to communicate with each other about the status of complex and confidential regulatory situations. However, the true success of FAWG is based on the regulatory community embracing and recognizing that working together is the best way to achieve a shared regulatory mission. ★

Randy Blumer is the executive director of the Wisconsin Insurance Security Fund.

> Mark Your Calendar!

> NOLHGA's 16th Annual Legal Seminar
July 17 & 18, 2008
Fairmont Copley Plaza
Boston, Massachusetts

An MPC meeting will be held July 15 & 16.

> NOLHGA's 25th Annual Meeting
October 7 & 8, 2008
Four Seasons Jackson Hole
Jackson Hole, Wyoming

An MPC meeting will be held October 6.



For more information on the meetings, please contact Sean McKenna at smckenna@nolhga.com.

left. So we have had to almost completely rebuild the executive staff here. I'm new, my first assistant and chief of staff is new, my general counsel and deputy general counsel are new, and my CFO is new. We have a new chief compliance officer, head of the claims division, and head of reinsurance.

How did you go about assessing the situation when you took over, and did you find that it was better or worse than you feared?

Some better, some worse. As I said, at the middle-management level and the staff level, the people who actually do the work on a day-to-day basis, it turned out there were a lot of very talented people doing a lot of very good work. So in that sense, it was actually a better situation than I had expected.

On the other hand, seven or eight months without any permanent leadership at the top had really ground a lot of things to a halt, and we had to get them going again.

What steps did you take to "right the ship?"

The first thing we did was, we put a lot of emphasis into recruiting a top-notch staff. We brought Ellen Russell and Gail Pierce-Siponen in, Ellen to run the Claims Division and Gail to be her deputy. That really got the Claims Division moving much more quickly and efficiently.

We also brought in Andrew Lorin as my general counsel and Tarik Ajami as his deputy, and that dramatically improved the legal operations around here so that, number one, we're being a lot more efficient and spending a lot less on outside counsel, and two, we're getting a much higher quality of legal work.

I brought with me Susan Pagoda, my first assistant and chief of staff, and she really began tightening the administration around here. We're spending money a lot more efficiently. I also brought Joe Liberatore in from Citibank as my CFO, so we now have a professional, private-sector budgeting process, which means we're being really careful with our financial resources and we can send more money to claimants because less money is going elsewhere.

I understand you also had a bureau-wide audit conducted.

Unfortunately, this place had never been fully audited. And if you're going to reform a place and run it properly so you have confidence in it, you need to do a proper annual audit, in which outside auditors come in and look at the books to confirm that the books are good.

We've engaged one of the top insurance auditing firms to come and do a top-to-bottom audit of this place. As a result, we've spent hundreds of hours going through the books, making sure that they are themselves accurate—going back historically as much as 20 years to make sure the balances are accurate and money hasn't been lost. It's been a very important part of turning this place around. We've learned a huge amount

about problems and fixed a lot of things in the course of doing this. And early in the new year, I hope in January or February 2008, the audit will be done and will be posted on our Web site (www.nylib.org) so that everybody can see what we've done to clean things up and make this place more transparent.

Are the big changes over with, or do you have more planned for the future?

We've done a huge amount already, but there's still a lot more to be done. We need to finish the audit, and we still have to finish all the work on ELNY. In addition, we have numerous estates that have been around for a long time, and I think it's high time we got them processed and closed. Those are the kinds of things that need to be done. We've made very good progress this year, but we need to spend next year finishing the job and following up. A lot of turning a place around is about following up and not merely stopping after you've gotten the first good reviews.

I've spent a fair amount of time talking with folks from the various guaranty associations, both on the life side and the property/casualty side, and I think there's a clear feeling that we need to do a better job getting distributions paid and moving estates along. I think the team we've got in place is capable of doing it, and the fact that we've already paid some big distributions in estates like Midland Insurance Company, and that after 22 years we've finally filed a court report on Union Indemnity Insurance Company of NY, are very good signs of the Bureau moving in the right direction. And we're going to spend next year solidifying those gains and really getting estates moving toward closure. And working with the guaranty associations to do that. This is a partnership—we can't do this without them.

One of the biggest challenges you discovered was the shortfall in the ELNY estate. How did you discover it, and what did you do once the problem was known?

Shortly after I got here, I had meetings with lots of people in the insurance industry about many different things, and one of the things that certain people mentioned to me was the situation with ELNY and the looming deficit that threatened the financial lifelines of thousands and thousands of accident victims. Upon learning about that, I met with my staff here and made them go through the numbers with me. Unfortunately, my predecessors, in addition to the other things they did wrong, had underreported the size of the ELNY deficit. The deficit was really quite significant—at least \$650 million.

Once we realized that the deficit was much larger than had been reported, we properly reported the scope of the deficit in our annual report to the legislature. I think this was very important, because the first thing you have to do when you're trying to solve a problem like this is to acknowledge the problem and acknowledge the scope of the problem. Until you're prepared to stand up and say, "We have a problem here, and it has to be dealt with," you're never going to be able to fully tackle it.

My predecessors had not dealt with the problem, allowing it

to pass on to the next administration—which it did. But I didn't take this job, and none of the people here took their jobs, just to pass problems on to the next administration. We took these jobs to come in and fix problems.

You mentioned that you met with insurance industry people who brought up the ELNY deficit. Was the problem well-known in insurance circles?

I don't think people knew the full scope of the problem. I think it was generally known that the financial reports the Liquidation Bureau had been filing weren't correct. Nobody ever said to me, "You have a problem with ELNY, and here's the size of it." That's the kind of bookkeeping we had to do. But people said to me, you have to look at this.

How did the "hole" grow so large without anyone being notified?

It got so big because the rate of return on investments didn't keep up with the projected rate of return in the plan.

Would the type of public audit you're performing now have caught the problem earlier?

Absolutely. Had an annual audit been done in the last five years, it would have revealed the problems with ELNY much sooner. And we will be doing those audits on an annual basis from here on out.

Have you or your staff talked with former bureau staffers to discover why they acted the way they did?

As I said, my immediate predecessor is under indictment, so we certainly haven't discussed it with her. At this point, I'm not interested in looking backward to figure out why people didn't do something. Right now, it's taking up all our energy here to move forward and fix the problem, and that's what we're doing.

Are there any plans to hold accountable those whose inaction caused or contributed to the problem?

There's no doubt that there's a need for accountability here. We have done our own internal review to figure that out, and we will take steps to have people held accountable where appropriate. But the first thing we have to do is fix the problem, and I don't want to let finger-pointing or accountability issues distract us from the very pressing need to get the problem fixed.

Did you experience any resentment from other regulators when you explained the scope of the problem? Were they angry that they hadn't been notified earlier?

Certainly, when I've been at NAIC meetings, various insurance commissioners have asked the totally legitimate question,

"Why are you telling us now?" But I think after people get over their initial shock, there's a sense of confidence that now a team is in place that's dealing with the problem. And at the end of the day, that's what's important.

That said, there are people taking very seriously how this place was run. My predecessor is under indictment. We're doing an audit now, we've done our own internal investigation, and we've cooperated with the prosecuting official. So we're taking very seriously whether people did what they should have done.

It would be easy for me to spend all my time blaming my predecessors for not getting the job done. What's harder is getting it fixed. I'm focused on that, but obviously we're cooperating with the district attorney's office here on a whole host of issues about how this place was run in the past. And we'll continue to do so because clearly, where there's been wrongdoing—and I'm not saying there was criminal wrongdoing in ELNY; in fact, I don't believe there was—but where there's criminal wrongdoing, you have to deal with it. But you can't just satisfy yourself with pointing fingers.

When did the bureau decide to bring the guaranty associations into its confidence, and why was the decision made?

Almost immediately, because there's almost nobody more important than the guaranty associations for dealing with these problems. The guaranty associations are on the front lines in helping deal with failed life insurance companies. They've got the expertise and the wisdom to figure out how to get through this, and indeed, I couldn't possibly have done this without them. Without the guaranty association folks, ELNY would be nowhere. I owe them a huge debt of thanks.

What sort of confidentiality issues did both sides have to deal with, and how were they handled?

There are a host of confidentiality issues when you're dealing with individuals' policies. What we did, and it's worked out very nicely, is create a global confidentiality agreement that each person signed and then needed to show to other people and get them to sign. That worked out rather neatly, and it's not been a problem at all.

What did the guaranty associations and NOLHGA offer the bureau that made you want to bring them into the assessment of the ELNY situation?

First of all, the guaranty associations are a significant source of payment. But additionally, the associations and NOLHGA are a huge source of wisdom in dealing with all this. The senior folks over there have experience dealing with insurance insolven-

If you're going to reform a place and run it properly so you have confidence in it, you need to do a proper annual audit.

“There’s no final agreement yet, but we’ve got the big building blocks of an agreement put together, and I am extremely confident that we’ll make it work.”

cies, in some cases, for decades. I’m a broken-down former prosecutor. They’ve got wisdom that I don’t have. And so in addition to the fact that they’re obviously a significant source of payment in closing the deficit, they’re a significant source of wisdom in how to go about structuring all this. And I couldn’t have done it without them.

On December 4, 2007, Gov. Spitzer announced an “agreement in principle” that would ensure full payment to all ELNY annuitants. Who are the major players in the agreement, and how did it come about?

Basically, there are three parties to it: the Liquidation Bureau; the life industry, which is largely represented by the guaranty associations; and the property/casualty industry. Those three groups have put together the building blocks of an agreement—which, over the next few months, we’ll hopefully finalize—that should provide sufficient funds into ELNY to allow it to fulfill 100% of its obligations.

Can you go into the amounts being contributed by each party?

Those are numbers that are still being calculated, so I’m a little reluctant to discuss that.

What were the main stumbling blocks in reaching this point?

I wouldn’t call it a stumbling block so much as a need to go out and explain to the life side and the property/casualty side that there really was a problem we had to deal with now, and getting people comfortable with the idea of everybody working together to fix it. And everybody’s first reaction was, “Why now, and why us?”

It happened pretty quickly—on the life side, folks really rose magnificently to the challenge and jumped in. And then there were huge numbers of technical things that had to be worked out and still have to be worked out. But that’s just the reality that doing this is hard work. And we’ve got a lot of very smart people involved in working out all the details.

On the property/casualty side, are companies participating because they’d taken out these structured settlements and would still be liable for them if ELNY failed?

That’s correct. They had obligations they were going to have to meet no matter what, and what we explained to them, and what they’ve come to understand, is that by working with us, we can do it in a more efficient way, probably a more cost-effective way,

and in a way that’s better for the policyholders. Doing this with us is good for them and for the policyholders. Everybody benefits.

As part of the agreement, will ELNY be placed in liquidation?

There will have to be some form of liquidation order. The exact legal details are being worked on.

What remains to be done to make the agreement in principle an agreement in fact?

Several things. There are a huge number of technical details about how the payments will work that need to be figured out, and we’ve got a bunch of very smart lawyers working on that. The exact amount of money being put in by all the parties needs to be finalized. And then each of the guaranty associations and the property/casualty companies has to finally look at it and approve it themselves.

There’s a lot more work to be done. There’s no final agreement yet, but we’ve got the big building blocks of an agreement put together, and I am extremely confident that we’ll make it work.

Are there any circumstances where annuitants won’t be paid in full even if the agreement is ratified?

It’s extraordinarily unlikely that anybody will not be paid in full. The plan is being designed to guarantee 100% payment, and we’ve done a huge amount of computer modeling to give us a high degree of confidence that it will work. It would take a true market catastrophe, of the kind not seen in recent years, to derail the plan.

Could you talk a bit about the role of the guaranty associations in the ELNY matter?

The guaranty associations are an incredibly central part of this. They’re a group of folks who I’ve now spent a lot of time meeting with, who have really just impressively risen to the challenge. I can’t overstate the gratitude I have toward the guaranty associations for the huge amount of hard work they’ve already put into this. I couldn’t have done it without them.

There’s one person in particular who’s worthy of a lot of credit on this, and that’s Peter Gallanis. I suspect that your members know how lucky they are to have Peter guiding NOLHGA, but he’s been an incredible source of smart, sage thinking as we went through ELNY, and when we finally solve this problem, it will be as much his victory as anybody else’s. ★

almost unanimously chosen to participate in the resolution plans developed by their task forces.

Why does that happen? In part it happens because it *has* to happen. Each of our member associations knows why it was formed, and none of them wants to see a poor or mismanaged outcome. In part, to go back to one of Chris Chandler's themes, it's because there is a high level of *trust* within this organization, both in the institutions we have developed—the MPC, the protocols, the guidelines—and the people we put in place to manage them. But beyond necessity and trust, another driver is that virtually all the members of our system—like the World War II veterans Ken Burns highlighted, and like those who have served before us in the guaranty system—are committed to the faithful execution of the mission we have been given.

The Need for Task Force Flexibility

"Protecting the Future"—the theme of this meeting—might sound simple. One might think it's just a matter of continuing to do what we've always done, of just putting one foot in front of the other. But I've heard several people at this meeting privately voice a concern that's worth some reflection.

The concern is that, with the change of personnel in our system and the length of time since we were last tested by a number of major new insolvencies, we might have a tendency to lose perspective and to forget what we can accomplish and how we do it.

A developing insolvency is an incredibly messy, chaotic situation. In virtually every case, if it's not true that the NOLHGA Task Force *is* the answer, then the Task Force *provides* the answers, often when no one else at the table can. There's a reason for that. During the period NOLHGA has been in existence, there have been some 400 or so P&C insolvencies. Most states' insurance commissioners and deputy receivers have a reasonable idea of what goes on in a P&C insolvency, what needs to be done, and how the P&C safety net mechanism fits into the picture.

By contrast, a lot of states, including some major ones, haven't seen a life insolvency in decades. They have no reservoir of experience; they do not know the critical differences between a life insolvency and a P&C insolvency; and they're often tempted to turn matters over to a few self-described life insolvency experts whose track records may have some surface glitter, but who in reality have done more harm than good.

In short, the prospects for an insolvency disaster—the type of story beloved by newspaper editors and *60 Minutes* producers—are significant. And the chances of a disaster increase with each passing day that the only people likely to generate informed input and analysis—the people involved with our task forces—are *not* present in the receivership "war room," working with the receiver's team on a resolution plan.

The conclusions that follow are these, and on these points every guaranty system "veteran" appears to agree: We *must* get on the scene of the insolvency early. We *must* be prepared to bring to bear

early substantial expertise, from within our system and from outside resources. We *must* earn respect and trust from the receiver and other stakeholders early on and throughout the process; without abandoning our own prerogatives, we want to be seen as an "honest broker." We *must* do the work that's necessary to provide for a smooth transition to liquidation. And sometimes—it's happened at least twice in major cases since I joined NOLHGA—our input can help the regulators find a way successfully to avoid a liquidation ever occurring, which ought to be viewed by any reasonable participant in this system as nothing other than a spectacular victory.

To put it another way, in major insolvency cases, it seems pretty clear that a task force needs the discretion, where warranted, to arrive on the scene early and well-equipped, often months before a liquidation order is entered, and in very rare (but critical) cases, even when the possibility exists that no liquidation may ever occur.

Most in this room are familiar with the TV series *M*A*S*H* and the movie that inspired it. The setting was a Korean War mobile surgical facility. The plots revolved around the surgeons and nurses who practiced what they described sardonically as "meatball surgery" under incredible stress and pressure.

A given in the world of *M*A*S*H*—one replicated in our world—is that, in real time, under intense pressure, major decisions simply *must* be made. Waffling, stalling, deferring, temporizing...these are in honesty simply decisions not to decide, and thus amount to bad decisions. In circumstances like *M*A*S*H*—or in the critical early period of a developing insolvency—it's often true, as the saying goes, that the perfect is the enemy of the good.

So in our world, how do we make the critical decisions that confront us? We make them through the representative team approach embedded in the task force and MPC process, a process designed by very thoughtful people like Bob Ewald, William Falck, Frank Gartland, and the leaders on the NOLHGA Board in the early 1990s. It's a process designed both to bring to bear in the insolvency our "best and brightest" and to cause them to take into account the interests of all affected guaranty associations in designing a resolution plan aimed at achieving—if possible—unanimous guaranty association acceptance.

That acceptance is almost always achieved—meaning that the process *works*—for two reasons. First, those appointed as chairs and members of our task forces have been good and capable people who take very seriously their responsibility of representing all affected associations, including particularly those not on the task force. Second, and this is *key*, the constitution of our MPC process—our bylaws, protocols, and guidelines—permits the task forces the latitude and flexibility they need to respond to a messy, evolving crisis in the way that seems most appropriate under the always unique facts of that case.

The people who put our processes together, the people who have led this organization over the years, the people who guided us through the wilderness of some potentially disastrous major insolvencies, knew the importance of giving our task forces the

necessary room to maneuver. The interactions, analysis, research, and preliminary negotiations that are presented in the early days of an insurer solvency crisis involve a kind of “meatball surgery,” where decisions have to be made quickly, almost on the fly. Those decisions are guided in part by the task force’s knowledge of the general boundaries established by law and by our group’s “constitution,” and also by the experience and common sense of the task force.

Some who haven’t lived through a major insolvency from the inside—or who haven’t from personal experience internalized the lessons of our history—may sometimes feel drawn to a somewhat different model of how insolvencies might be handled: to the notion that perhaps we need more rules and protocols to restrict the flexibility of our task forces. There is something understandably comforting about the notion that we might be better served if we could provide in advance a rule governing every possible eventuality.

While I understand that sentiment, I see at least two problems with it. The first is that it might so hamstring our task forces as to make it virtually impossible for them to respond to the real-time demands of a breaking insolvency in the way that would

best serve our membership. The second concern involves the essence of a comprehensive, rules-based system designed to govern all eventualities. Such a mechanism would necessarily be drawn from, and would focus on, what was needed to fight the *last* war, whereas the concern of each new task force is how to fight the *next* one. And the next war, as author Nassim Nicholas Taleb writes in his current best-seller, *The Black Swan*, has a disturbing way of being much different from the wars that have come before.

So again, when I say that the state of the organization is strong, what I mean primarily is that we continue to have a solid and thoughtfully constructed system, well-designed to perform our mission; that it is populated with some very experienced and capable people at every important level; that it is focused on the critical challenges and issues that demand this organization’s attention; and that its performance over the past year in every instance where it has been tested should earn today’s guaranty system representatives the trust and respect even of the giants who have gone before us.

It has been an honor to serve you for another year. ★

Peter G. Gallanis is president of NOLHGA.



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The views expressed herein are those of the authors and do not necessarily reflect those of NOLHGA or its members.

NOLHGA Calendar of Events

2008

March 28–30	IAIR Spring Quarterly Meetings Orlando, Fla.	July 17–18	NOLHGA's 16th Annual Legal Seminar Boston, Mass.
March 29–31	NAIC Spring National Meeting Orlando, Fla.	September 20–22	NAIC Fall National Meeting Washington, D.C.
April 24–25	NCIGF Annual Meeting Ft. Lauderdale, Fla.	October 6	MPC Meeting Jackson Hole, Wyo.
April 29–30	MPC Meeting Raleigh, N.C.	October 7–8	NOLHGA's 25th Annual Meeting Jackson Hole, Wyo.
May 30–June 1	IAIR Summer Quarterly Meetings San Francisco, Calif.	October 19–21	ACLI Annual Conference Boston, Mass.
May 31–June 2	NAIC Summer National Meeting San Francisco, Calif.	December 6–8	NAIC Winter National Meeting Grapevine, Tex.
July 15–16	MPC Meeting Boston, Mass.		