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More Than a Guaranty

Taiwan's new guaranty fund consolidates the guaranty and receivership functions for the life/health and property/casualty markets

By Shu-Hui Liao & Cheng-Hsien Tsai

Taiwan's guaranty fund was established in 1992 when the Insurance Law of Taiwan was revised. The purpose of the fund was to protect the benefits of policyholders and maintain the stability of financial markets when insurers become insolvent and are unable to honor their issued policies.

During the early days of its existence, Taiwan's guaranty fund was not a separate legal entity; rather, it fulfilled the roles of fund supplier and custodian for Taiwan's insurance supervisor. The fund became a separate organization after the revision of the Insurance Law in 2001. The law allowed the fund to act as the debt holder of a troubled insurer and secure subrogation rights whenever the fund pays policyholder claims.

The most recent Insurance Law revision (in 2007) and subsequent regulation further specified the organizational structure of the guaranty fund. The board of directors, headed by a chairman, designates a chief executive officer to implement the policies set by the board and manage the operations of the fund. The fund itself has three departments. The finance department handles accounting and oversees the cash flow and assets of the guaranty fund; the business department deals directly with the troubled or insolvent insurer; and the administration department covers logistics.

With the 2007 revisions, the fund is now able to form a team to take over an insolvent insurer and hire full-time staff and part-time experts to handle insolvencies. It can also carry over the policies written by the troubled insurer, act as the legal agent of the policyholders when restructuring the company, and arrange for transfer of the policies to a financially sound company.

Integrating Functions

The revised Insurance Law of 2007 also designated the guaranty fund to serve as the receiver and liquidator of insolvent insurers. As receiver, the guaranty fund has the right to negotiate with potential buyers on behalf of the insolvent insurer and to manage the insurer's assets.

The rationale behind this role integration lies in economies of scale. There are approximately 60 insurers in Taiwan as of 2008, and there have been a total of 2 insolvencies in the last 40 years—a life insurer insolvency occurred four decades ago, and a property/casualty insurer became insolvent in 2005. Based on this history, the industry's organization, and prudent regulation, regulators as well as

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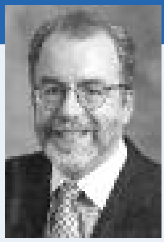


Opportunities in "Interesting" Times: The Subprime Crisis, the Paulson Blueprint & Beyond

While growing up, I was a faithful reader of the newspaper essays by the now almost forgotten syndicated columnist Sydney J. Harris,[1] who periodically wrote essays headed, "Things I learned while looking up other things." I had a "Sydney moment" recently leading me to this fact: Our (Western, English-speaking) culture has a habit of manufacturing supposedly ancient and supposedly Chinese sayings, where both the age and Chinese origin are fictions, apparently supplied to add weight or profundity to aphorisms that often could stand on their own.

For example, one often hears what is alleged to be an ancient Chinese curse: "May you live in interesting times."[2] But if you set off to find the original author of that curse (so that credit may be given where due), you will learn that there is little or no basis to conclude that the curse is either ancient or Chinese. In this case and others like it, the age or provenance of the quotation has become almost irrelevant except as a cliché. The real power of the saying is in how right it feels: "Interesting" times often are quite unpleasant or even dangerous.

In the several months since my last column, the times have gotten particularly interesting for those engaged in the field of financial services generally, including the insurance industry. The general U.S. economy has moved to the brink of (and perhaps into) a recession, and some respected economic experts now predict that the slump may be long and deep. The mortgage situation in particular has gotten grim, with profoundly negative consequences for many people from Main Street to Wall Street. A political sea change seems possible in the coming elections—one that may result in a higher degree of government regulation of market activities. Bankruptcies and insolvencies seem to be increasing, including insurance insolvencies. At the same time, authoritative voices have called for fundamental restructuring of the American financial services regulatory system. All this has made for an interesting few months—arguably the most turbulent three months in American financial history since the Great Depression.

The Story So Far

Too much has been written elsewhere about the "subprime crisis" for much history to be needed in this space. For several years before 2007, interest rates were low; mortgages were easily available, even to people who weren't great risks for repaying them; and Wall Street showed startling creativity in finding new ways to package such subprime mortgages together into funds sometimes referred to as "structured investment vehicles" or SIVs and to develop derivative (and often highly leveraged) ways to invest in and around such SIVs. The Wall Street market for SIVs and mortgage derivatives both responded to and fueled new loans to subprime mortgage borrowers. While the bubble was expanding, everyone appeared to be a winner. Consumers bought houses that previously would have been beyond their means, and Wall Street players made lots of money on large volumes of mortgage-based financial products.

The problem, as in every financial markets bubble,[3] was that the success of the financial positions taken—whether by mortgage borrowers on Main Street or hedge fund speculators on Wall Street—was materially dependent on some *next* investor being willing to step up and assume the position of the last investor at an equal or higher price, whether that required a home buyer willing to purchase a home at a price that would extinguish a subprime borrower's debt or a hedge

> The Blueprint's proposed intermediate-term changes, which are among the most controversial elements of the document, aim squarely at eliminating gaps and redundancies in the current regulatory framework.

fund investor willing to buy a stake in a derivative venture. With an investment universe that was expanding rapidly and a finite number of potential new investors, sooner or later the supply of new home buyers willing to pay record prices had to diminish. When there were few consumers left to buy homes at inflated prices, over-leveraged subprime mortgage borrowers quickly ceased to be "landed gentry" and suddenly became mortgage default statistics.

That would have been bad enough had it all stopped with the poor homeowners facing foreclosure, but the loans made to those homeowners were the foundation level of all of the SIVs and mortgage derivatives that had been making fortunes for Wall Street bankers for several years. When widespread subprime mortgage defaults by borrowers began to be predicted in 2006, investments in subprime SIVs and related derivatives began to be viewed as toxic, and soon the Wall Street rout was on. The damage has been profound among formerly glittering names, both among investment banks and commercial banks. Some insurers have also seen significant damage to their portfolios. The Wall Street damage was most clearly seen in the failure of the venerable investment banking firm Bear Stearns in mid-March, along with severe earnings losses reported by other major U.S. and foreign firms.

A total failure of Bear Stearns was viewed by many, including federal decision makers, as a severe threat to the general economy. Specifically, the concern was that a Bear Stearns bankruptcy would freeze many billions of dollars of transactions in which the firm was involved, which in turn would produce "contagion" resulting in a domino-like series of failures of other investment and commercial banking firms. Federal Reserve Chairman Ben Bernanke viewed such a prospect as similar to the epidemic of commercial bank failures at the start of the Great Depression, and, as a student of the Depression, Bernanke was determined to avoid a similar outcome in 2008. Accordingly, Bernanke and Treasury Secretary Hank Paulson collaborated with other government officials to facilitate the sale of Bear Stearns at a bargain price to the investment banking firm J.P. Morgan Chase over the weekend of March 15 and 16.

A government role in resolving the failure of a financial institution is not inherently surprising. The Fed was intimately involved in brokering the resolution of the similar failure of the hedge fund Long Term Capital Management (LTCM) in 1998, and the FDIC routinely directs the resolution of bank insolvencies. However, the FDIC's role is limited to banks whose deposits are protected by explicit FDIC guaranties, and the LTCM rescue involved no financial commitment by the federal government (either in cash or through guaranties).

By contrast, the rescue of Bear Stearns (whose accounts were *not* insured by the FDIC) involved the voluntary (non-mandated), explicit, and direct assumption by the federal government of up to $30 billion of credit risk, a risk assumption that was said to have been required as a condition to J.P. Morgan's participation in the rescue. Moreover, within hours of the Bear Stearns resolution, the Federal Reserve announced that its "discount window" would for the first time open to investment banking firms, so as to provide a source of liquidity that (it was hoped) would prevent some circumstances of the Bear Stearns failure being replicated at other banking houses.

There were a number of important reactions to the Bear Stearns rescue from the moment it was announced. Economists and financial writers raised questions about whether the government rescue had been necessary and whether it raised serious issues of moral hazard by signaling that similarly troubled investment banks (and perhaps other types of businesses) likely would now be "bailed out" by the federal government should they face future solvency crises.[4] Influential voices in and out of government stated that federal solvency protection (through Bear Stearns–type guaranties and via the Fed discount window) must be accompanied by an enhanced federal solvency regulation role that previously has not existed for investment banks.

The Bear Stearns rescue also provoked political reactions, including arguments by presidential candidates and others that, since the government has now assumed the role of rescuing and otherwise protecting investment banks threatened by the subprime crisis, there is now no principled argument against federal relief programs directly targeting subprime mortgage borrowers. Not coincidentally, several such proposals in March would have devoted $30 billion of federal funding to mortgage borrower relief (the same funding as the original amount of the Bear Stearns guaranties).

If there had existed some sort of conceptual "firewall" restraining an increased governmental role in various types of financial bailouts, that firewall may have been incinerated by the Bear Stearns rescue. Since that event, it has become common in economic policy discussions for someone to say, "If the federal government can spend $30 billion to rescue a big Wall Street investment banking firm, then surely federal resources can be applied to protect…"[5]

["Opportunities in Interesting Times" continues on page 9]

The Lawyers Are

Public policy and guaranty association fundamentals highlight the NOLHGA Legal Seminar's visit to Boston

Boston is a city justifiably proud of its history and historical figures, from Paul Revere to Ben Franklin to the band Aerosmith. Another chapter in that history will be written this July, when Boston plays host to NOLHGA's 16th Annual Legal Seminar. With a program that covers the waterfront of public policy issues shaping the industry as well as the mechanics of how guaranty associations operate, the seminar is a must for anyone wishing to get a firm grasp on the challenges facing the industry and the guaranty system.

Three If By Congressional Action

Day one of the two-day program ("Fish and visitors smell in three days."—Ben Franklin) focuses on public policy issues facing the industry, including federal versus state regulation of insurance, the subprime mortgage crisis and its effects on the industry, the challenge of providing health insurance to the uninsured, the continued vitality of McCarran-Ferguson, taxes, and more.

One of the highlights of the program is a panel discussion on the potential role of the federal government in insurance regulation. With the Department of the Treasury's March announcement of its financial services modernization blueprint and a new Congress and Administration on the horizon, it's safe to say that the panelists will have plenty to discuss.

The importance of the issue is matched by the stature of the panelists. ACLI President and CEO Frank Keating will offer the insurance industry's perspective, while Illinois Insurance Director Michael McRaith will speak for state regulators. The panel also includes Karen Shaw Petrou of Federal Financial Analytics, a nationally recognized commentator on financial services, and NOLHGA President Peter Gallanis. Refereeing the free-for-all will be Charlie Richardson of Baker & Daniels.

Another presentation will tackle the highly complex subprime mortgage crisis, with Michael Braun (McKee Nelson) and Robert Armour (Huron Consulting) explaining how the underlying transactions are structured, how the crisis has spread through the U.S. and world economies, and what impact the crisis might have on the U.S. insurance industry.

Other presentations will address the impending financial difficulties of Medicare/Medicaid and Social Security, possible tax reforms affecting the insurance industry, what the presidential candidates have in mind for helping 45 million uninsured Americans, and both the history and future of the industry's McCarran-Ferguson antitrust exemption. In all, day one of the legal seminar will provide attendees with a comprehensive overview of the environment in which the insurance industry and the guaranty system exist, with in-depth analyses of the forces that have the potential to shape and change that environment in the coming years.

More Than a Tea Party

After an evening reception ("Beer is living proof that God loves us and wants us to be happy."—Ben Franklin) to

John F. Kennedy Presidential Library and Museum, site of the July 16 Welcome Reception

Coming

All This & CLE Too!

While the phrase "legal ethics" is always good for a few snickers ("A countryman between two lawyers is like a fish between two cats."—Ben Franklin), NOLHGA will seek CLE credit, including ethics, in all states that require it.

conclude day one, day two will offer attendees a comprehensive overview of the nuts and bolts of guaranty association operations. A panel on rehabilitation/liquidation basics will feature a breakdown of the key steps in the insolvency process, as experts with decades of experience working with troubled companies explain the roles of the major parties involved as well as the importance of the guaranty associations.

The panel includes receivers—Tom Collins, the Special Master for Texas receiverships, and Dave Wilson of the California Conservation and Liquidation Office; an administrator (Bart Boles of the Texas guaranty association); and a number of attorneys with extensive experience on NOLHGA task forces (Frank O'Loughlin and Joel Glover of Rothgerber, Johnson & Lyons; Jacqueline Rixen of the Law Office of Jacqueline Rixen; and NOLHGA's Bill O'Sullivan).

Come to Boston in the Summertime

What
NOLHGA's 2008 Legal Seminar
www.nolhga.com/2008LegalSeminar.cfm

When
July 17 & 18, 2008 (an MPC meeting will be held July 15 and 16)

Where
Fairmont Copley Plaza
Boston, Massachusetts
www.fairmont.com/CopleyPlaza
Room Rate: $219/night plus tax
Hotel Cut-off Date: June 20, 2008

How Much?
$650, minus a $35 early bird discount if you register before June 10

Welcome Reception
July 16, 6:00 p.m. to 9:00 p.m.,
at the John F. Kennedy Presidential Library and Museum
http://www.jfklibrary.org/

Sox
Not in town that week. Sorry.

Another panel will discuss the responsibilities of guaranty association board members, offering perspectives from a board member (Michael James, who serves on the Delaware and Pennsylvania boards), an administrator (John Colpean of the Michigan association), and an insolvency task force legal counsel (Kevin Griffith of Baker & Daniels). Tad Rhodes of the Oklahoma guaranty association will then give a speedy overview of the major legal decisions and precedents in the past year that affect the guaranty associations. In all, the three presentations will provide all attendees—newcomers to the guaranty system as well as experienced professionals looking for a refresher course—with the background they need to participate in the work of the system in 2008 and beyond. ✯

Preliminary Agenda

Wednesday, July 16, 2008

6:00 – 9:00 p.m. **Welcome Reception**
John F. Kennedy Presidential Library and Museum

Thursday, July 17, 2008

7:30 – 8:10 Breakfast

8:10 – 8:30 **Opening Remarks & Welcome**
- Peter G. Gallanis: President, NOLHGA
- James W. Rhodes: Chair, NOLHGA Legal Committee
- Charles D. Gullickson: Chair, Legal Seminar Planning Committee

8:30 – 9:30 **The Impact of the Subprime Mortgage Meltdown on the Insurance Industry**
- Michael P. Braun: McKee Nelson
- Robert E. Armour: Huron Consulting

9:30 – 10:15 **Covering the Uninsured—What the Presidential Candidates, the Industry and Others Are Proposing**
- Stephen J. Northrup: WellPoint

10:15 – 10:30 Break

10:30 – 11:15 **Post-Election Tax Reforms for the Industry**
- Ann B. Cammack: Massachusetts Mutual Life

11:15 – 12:00 **Principles-Based Insurance Regulation: What Is Its Future in NY and Elsewhere?**
- Thomas E. Workman: LICONY

12:00 – 1:45 **Lunch/Featured Performer**
- John Forster

2:00 – 3:15 **A Roundtable Discussion of Perspectives on the Role of the Federal Government in Insurance Regulation**
- Charles T. Richardson: Baker & Daniels (Moderator)
- Karen Shaw Petrou: Federal Financial Analytics
- Peter G. Gallanis: NOLHGA
- Director Michael T. McRaith: Illinois Division of Insurance
- Governor Frank Keating: ACLI

3:15 – 3:30 Break

3:30 – 4:15 **Antitrust Immunity Under McCarran-Ferguson: 1940s, Today and Tomorrow?**
- Craig A. Berrington, Wiley Rein

4:15 – 5:00 Wine & Beer Reception

Friday, July 18, 2008

7:30 – 8:00 Breakfast

8:00 – 9:30 **Rehabilitation/Liquidation Basics**
- Bart A. Boles: Texas Life, Accident, Health & Hospital Service Insurance GA
- Special Master Tom Collins: Texas Insurance Receiverships
- Joel Glover: Rothgerber, Johnson & Lyons
- Franklin D. O'Loughlin: Rothgerber, Johnson & Lyons
- William P. O'Sullivan: NOLHGA
- Jacqueline Rixen: Law Office of Jacqueline Rixen
- David E. Wilson: California Conservation and Liquidation Office

9:30 – 9:45 Break

9:45 – 10:30 **Challenges of a GA Board Member: Standards of Care and Other Factors Affecting Board Decision Making**
- John C. Colpean: Michigan Life & Health Insurance Guaranty Association
- Kevin P. Griffith, Baker & Daniels
- Michael A. James, Life Insurance Company of North America

10:30 – 11:00 **Case Developments**
- James W. Rhodes: Oklahoma Life & Health Insurance Guaranty Association

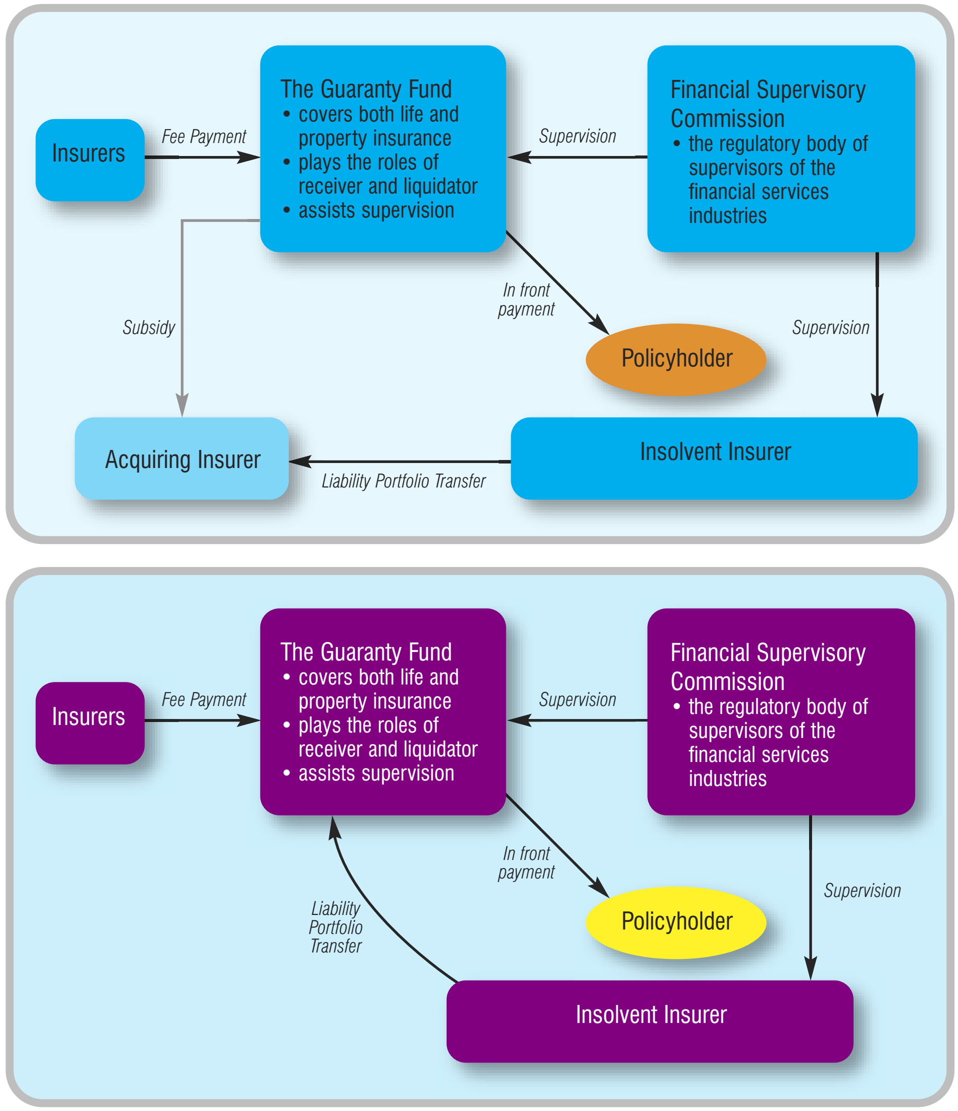
11:00 – 12:00 **Ethics: Sue Unto Others As You Would Have Them Sue Unto You**
- Sean Carter: Lawpsided Press

["More Than a Guaranty" continues from page 1]
legislators expect few or no insolvencies in the future. Integrating the roles of receiver, liquidator, and guaranty fund is therefore cost-effective.

Furthermore, such integration seemed to work well in the past two insolvencies. For instance, the Taiwan Insurance Institute (TII) was both receiver and liquidator in the recent property/casualty insolvency, and the TII also acted for the guaranty fund since the fund had no staff at that time. Although the TII was stretched in handling the insolvency, it accomplished the tasks of preserving policyholders' rights and transferring policies to another insurer while incurring very low costs. With this in mind, the revision of the Insurance Law in 2007 specified that the receivership and guaranty functions would be handled by the guaranty fund.

The same rationale—economies of scale—lies behind the combination of life and property/casualty guaranty fund operations.[1] Since the insurance supervisor expects no or few insolvencies in both the life and property/casualty insurance markets, establishing a single organization instead of two may be more cost-effective. Furthermore, a single organization may accumulate insolvency experience more rapidly than two separate ones, which reduces operational risk (especially when many guaranty fund functions are similar in both markets). A single organization will also enjoy more (human) resources and be more consistent in case handling.

On the other hand, the single fund will probably develop less expertise in a particular insurance market. Combining the guaranty fund function with receiver and liquidator functions could also slow down the development of expertise in each function. The regulators of Taiwan are aware of the potential weakness, but they expect the insolvencies that might occur in Taiwan to be less complicated than the cases in the United States, Japan, and other developed countries. Furthermore, the single fund can still set up individual task forces to tackle life insurance and property/casualty insurance insolvencies, which should mitigate the specialty concern to some extent. This concern is hence outweighed by the economies of scale, and we have vertical and horizontal integrations in our guaranty fund system.



Taiwan's Guaranty Fund System: The Guaranty Fund can arrange for the transfer of policies to a financially sound company (top) or administer the policies itself (bottom).

A Pre-funded System

The guaranty fund of Taiwan is pre-funded. It assesses 0.2% of total premiums on property/casualty insurers and 0.1% of total premiums on life insurers. The fund itself has the right to adjust the assessment rate according to its financial condition, subject to the approval of the insurance supervisor. The fund can also borrow money from financial institutions, backed up with guarantees from its member companies. Therefore, the guaranty fund of Taiwan has no insolvency risk.

The assets of the guaranty fund are invested conservatively and used prudently. The collected premiums can only be deposited in banks or invested in high-quality, fixed-income securities such as Treasury securities, CDs, and bankers' acceptance. The funds of the guaranty fund can be used only as loans to troubled insurers, subsidies to the buyers of troubled companies, or benefit payments to the policyholders of troubled insurers.

Handling an Insolvency

As mentioned earlier, the TII was designated by the insurance supervisor to handle the 2005 insolvency of a property/casualty insurer. Immediately after the insurance supervisor declared that the company had entered

receivership status, the TII sent a team consisting of its staff and experts from the insurance industry into the insolvent insurer to secure the assets. The team suspended all payments to various parties of stakeholders, including policyholders at first. The guaranty fund then paid policyholder claims after careful review.

The payment was 90% of the claim amount subject to the $100,000 coverage limit of the fund.[2] The guaranty fund also paid 40% of the surrender value to policyholders who surrendered their policies. Policyholders may be better compensated later by the proceeds from liquidation—the TII is still liquidating this insurer's assets and assessing the distribution among all claimants, and the process may take several years.

This case was handled well. Policyholders seemed to be satisfied with the measures adopted by the regulators and the TII, since few complaints were received. The financial markets remained stable, and the stocks of other insurance companies were not adversely affected. Most employees of the insolvent insurer were transferred to the newly established company that assumed a significant portion of the insolvent insurer's liability portfolio. Furthermore, the guaranty fund for the property/casualty insurance industry was sufficient to cover all expenses and deficits.

Plans for the Future

The guaranty fund of Taiwan is forming its board of directors now, and specific operational plans will be developed in the future. The top priority will probably be founding a team that is ready to take over an insolvent insurer and handle the guaranty and receivership functions. The board will also carefully estimate the amount needed to cover potential insolvencies in the future and examine ways to secure the needed funds. The fund may also assist regulators in monitoring insurance companies and providing early warnings in the future. We expect this new form of the guaranty fund to be an effective way to deter extreme moral hazard behaviors of insurers and help further development in the insurance markets of Taiwan. ✯

Shu-Hui Liao is Director of the Research Department at the Taiwan Insurance Institute (Taipei, Taiwan). Cheng-Hsien Tsai is an Associate Professor at National Chengchi University and is also Director of the Taiwan Insurance Institute.

End Notes

1. The separate accounts for life insurance and property/casualty insurance do not subsidize each other, even when one of them is in need of funds (the legal separation of the two accounts is expected to be enacted later this year by the insurance supervisor). Borrowing and lending between these two accounts, when necessary, must be overseen and approved by regulators.
2. Payments for mandatory auto liability insurance and residential earthquake insurance were not subject to these limits.

Contact the Authors

Since our guaranty fund is still in its early stages and has little experience in handling insolvencies, we would appreciate readers sharing any experiences, thoughts, or suggestions about our system. We can be reached at:

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The Paulson "Blueprint": What the Future May Hold

Meanwhile, back on the policy front, we also saw on March 31 the release by Treasury Secretary Henry Paulson of a whitepaper entitled, "Blueprint for a Modernized Financial Regulatory Structure" (the "Blueprint"), which proposes changes to the U.S. system of financial services regulation more sweeping than anything seriously advocated since the early days of FDR's first term. The Blueprint received immediate reactions from politicians, pundits, academics, and industry spokespersons, many of whom rather obviously had not spent much time reading the document. Among the knee-jerk reactions were some that were purely partisan, others expressing dismay at how little the Blueprint would do to resolve the subprime crisis, and yet others arguing that the Blueprint called for either too much or too little substantive regulation of the financial marketplace.

Attendees at NOLHGA's 24th Annual Meeting in October 2007 will recall that Assistant Treasury Secretary David Nason, said by some to be the chief drafter of the Blueprint, stated then that the objective of the Treasury effort was to investigate and make recommendations regarding the overall structure of financial services regulation. As Mr. Nason explained, the purpose was never to propose a solution to the subprime crisis, nor was it to express normative standards for the proper levels of regulatory oversight. Instead, the purpose, as reiterated in the Blueprint itself, is to investigate how government can best promote economic growth and stability by facilitating a sound, competitive, stable, and innovative financial services industry while also providing strong protection for consumers.[6] While the Blueprint has its critics, it has also received significant praise from legislators like House Financial Services Committee Chair Barney Frank (D-Mass.) and Paul Kanjorski (D-Pa.), neither of whom is considered a supporter of the current administration.

The Blueprint[7] is a lengthy document that reviews and analyzes the history and structure of the regulatory mechanisms applicable to all principal sectors of the financial services marketplace: securities, commodities, investment banking, commercial banking, thrift institutions, credit unions, insurance, and government-sponsored enterprises, among others. Based upon that review and analysis, the Blueprint reaches several fundamental conclusions. First, the current system, which developed incrementally—based in some cases on models designed to deal with the industries and markets of the 1930s—has not kept pace with developments in the regulated industries and markets. Second, the current regulatory structure, which focuses on functions and actors within particular market sectors (e.g., the SEC regulating securities, the CFTC regulating commodities, the OCC regulating banks, the OTS regulating thrifts, and so on) has a systemic tendency toward inefficiencies involving both duplicative regulation and regulatory "gaps." Third, a mechanism or authority is needed within the federal government to monitor and respond to systemic financial risk that may pose broad threats to the general economy.

The Blueprint makes several specific suggestions for improving the regulatory system, dividing the suggestions into categories of improvements that can be made in the short-term future, intermediate-term improvements, and longer-term suggestions regarding the conceptual design of an "optimal" regulatory structure.

The recommended short-term improvements include reinvigorating the "President's Working Group on Financial Markets" (PWG), a kind of "economic cabinet" established in the aftermath of the 1987 stock-market crash to provide policy advice and guidance on financial issues of national importance; establishing standards and new regulatory controls for federal "liquidity provisioning," such as the opening of the Fed's discount window to investment banks after the Bear Stearns failure; and imposing new standards for mortgage loan originations, especially at the state level, where regulation now is highly inconsistent and in some cases negligible.

The Blueprint's proposed intermediate-term changes, which are among the most controversial elements of the document, ➤

The Blueprint reaches some very favorable conclusions about the current state-based insurance guaranty system, recommending its retention for the OFC regime proposed as an intermediate-term regulatory improvement and suggesting that, even in the longer-term "optimal" regulatory structure, a state-based insurance guaranty mechanism may be the best option.

aim squarely at eliminating gaps and redundancies in the current regulatory framework. The proposals include (among others) eliminating the separate charter for thrift institutions and having all banks and thrifts regulated by the OCC; the merger of the CFTC and the SEC; and the establishment of an express federal insurance regulatory role. The Blueprint endorses the concept of optional federal chartering (OFC) but recognizes that Congress is likely to spend some years resolving that issue. In the meantime, the Blueprint suggests as an interim step the establishment of an "Office of Insurance Oversight" (OIO) within the Treasury Department to address international insurance regulatory issues (such as reinsurance collateral) and to advise the Treasury Secretary on major issues of domestic and international insurance regulatory policy.[8]

For the longer term, the Blueprint recommends a move away from our historical structure of functional regulation toward an objectives-based regulatory structure shaped by the goals of regulation rather than by the markets in which business is done or the entities doing that business. Specifically, the Blueprint advocates creation of one federal regulatory authority that would be responsible for the "prudential" (financial safety and soundness) regulation of financial market activity (regardless of entity type) involving explicit governmental guaranties; a separate federal authority that would regulate business conduct and consumer protection issues (again, regardless of entity type); and a third "market stability" regulator (the Federal Reserve) that would be charged to monitor and protect against broad risks to the financial system that could threaten the general economy.

Most significantly for this column's regular readers, the Blueprint reaches some very favorable conclusions about the current state-based insurance guaranty system, recommending its retention for the OFC regime proposed as an intermediate-term regulatory improvement and suggesting that, even in the longer-term "optimal" regulatory structure, a state-based insurance guaranty mechanism may be the best option. In that regard, Secretary Paulson's position is consistent with the "safety net" provisions of the OFC bills now before the House and the Senate.

Danger and Opportunity

I noted at the start of this column that the "interesting times" curse is apocryphal, at least as to its alleged ancient Chinese origins. There is a similarly apocryphal piece of "ancient Chinese" wisdom now often cited—that the Chinese ideogram for "crisis" supposedly is a synthesis of the terms "danger" and "opportunity." Once more, the ancient Chinese origins of the proposition wither under scrutiny, but, as with the "interesting times" curse, there remains innate power in the thought itself. Periods of unrest often do present both dangers and opportunities.

Those who advocate real regulatory reform in the financial services arena have reason to be both concerned and hopeful about the current U.S. financial unrest. A financial crisis—particularly one like the mortgage crisis, which now threatens a significant number of ordinary citizens with real hardship—can precipitate a political rush for solutions that may not be fully thought out. The risk of unintended consequences is high.

Those who advocate real regulatory reform in the financial services arena have reason to be both concerned and hopeful about the current U.S. financial unrest.

On the other hand, any time when regulation of the financial marketplace is being closely reviewed is also a time when changing the regulatory system can most easily be accomplished. The challenge is in demonstrating that changes that will truly modernize and improve the financial regulatory system will also prove beneficial to financial services consumers.

I would make one other observation in that vein: For politicians and journalists, rightly or wrongly, the one incident that goes wrong (or even appears to go wrong) is more noteworthy than years of things going well. When the political and journalistic focus is on protecting troubled consumers, an institution like the guaranty system must now, more than ever, deliver consistently and effectively on consumers' expectations. If we do, we have every prospect of turning the crisis state of these interesting times into an opportunity for continued growth and development. ✯

Peter G. Gallanis is president of NOLHGA.

End Notes

1. Harris, who died in 1986, made his mark at the now-defunct *Chicago Daily*

News, where he worked with a talented group of writers including Mike Royko, Peter Lisagor, and Georgie Anne Geyer.

2. In a slightly more extended version, that phrase is sometimes followed by, "May you get that which you prayed for; may you come to the attention of people in high places; may your friends always be at your back; and may your enemies be patient."
3. See, e.g., the Internet stock bubble of the late 1990s, addressed to some extent in my column, "Financial Services Modernization: Back to the Future?" in the spring 2000 issue of the *Journal*.
4. At the time of the rescue, Secretary Paulson denied that the Bear Stearns plan raised issues of moral hazard, noting the extreme stock value losses suffered by Bear Stearns shareholders. However, a number of commentators have opined that moral hazard was nonetheless created for counterparties in transactions with investment banks, since such counterparties now may have less incentive to consider the creditworthiness of investment banks with which they deal.
5. One particularly challenging situation that may generate such an argument involves the "monoline" insurers, which established their core businesses beginning in the 1970s by providing financial guaranties of traditional and relatively safe and stable municipal bond securities. Beginning around the mid-1990s, however, most monoline insurers branched out to provide guaranties of non-municipal structured financial products, many relating to mortgage-based securities. Those guaranties now appear substantially at risk, posing a significant threat to the viability of several established monoline companies.
6. Blueprint, Executive Summary, p.1.
7. Available at http://www.treas.gov/press/releases/reports/Blueprint.pdf.
8. Within days of the Blueprint's release, Representative Kanjorski (D-Pa.) introduced H.R. 5840, the "Insurance Information Act of 2008," which substantially responds to the Blueprint's OIO recommendation by establishing an Office of Insurance Information within the Treasury Department.

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NOLHGA Calendar of Events

2008

July 15–16	**MPC Meeting** **Boston, Massachusetts**	**October 7–8**	**NOLHGA's 25th Annual Meeting** **Jackson Hole, Wyoming**
July 17–18	**NOLHGA's 16th Annual Legal Seminar** **Boston, Massachusetts**	October 19–21	ACLI Annual Conference Boston, Massachusetts
September 19–21	IAIR Fall Quarterly Meetings Washington, DC	November 6–7	NCIGF/IAIR Joint Seminar Scottsdale, Arizona
September 22–24	NAIC Fall National Meeting Washington, DC	December 6–8	NAIC Winter National Meeting Grapevine, Texas
October 6	**MPC Meeting** **Jackson Hole, Wyoming**	December 6–8	IAIR Winter Quarterly Meetings Grapevine, Texas