



A National Alliance of Life Companies

HIGHLIGHTS

NATIONAL ALLIANCE OF LIFE COMPANIES *An Association of Life and Health Insurance Companies*

NALC Highlights



2007 Fall Conference Report

The Coeur d'Alene
Coeur D'Alene, Idaho
September 12-15, 2007



The NALC held its 2007 Fall Conference September 12-15, 2007, at The Coeur d'Alene, Coeur D'Alene, Idaho. Following are summaries of presentations by participating speakers.

Commissioners Panel

The NALC was pleased to host insurance commissioners from six states at our Fall Conference. Speakers included Director Bill Deal of Idaho, Commissioner Mike Kreidler of Washington, Commissioner Joel Ario of Pennsylvania, Commissioner Kent Michie of Utah, Director Tim Wagner of Nebraska and Commissioner Scott Richardson of South Carolina.



Scott Quist, Joan Deal, Director Bill Deal and Rob Miller



Commissioner Mike Kreidler & Kathy Demarino

Director Bill Deal

Director Deal was appointed Insurance Director after the election of Butch Otter as Governor in 2006. Director Deal spent forty six years in the insurance business and eight terms in the state legislature. He brings a vast amount of experience to the job. Director Deal expressed strong support for state regulation and for better regulation of military sales. He also mentioned a strong interest in long term care issues.

Commissioner Mike Kreidler

Mike Kreidler is one of eleven elected commissioners. He has varied experience in government, including service in the legislature and the U.S. Congress. The Commissioner provided an excellent overview of the impact of global

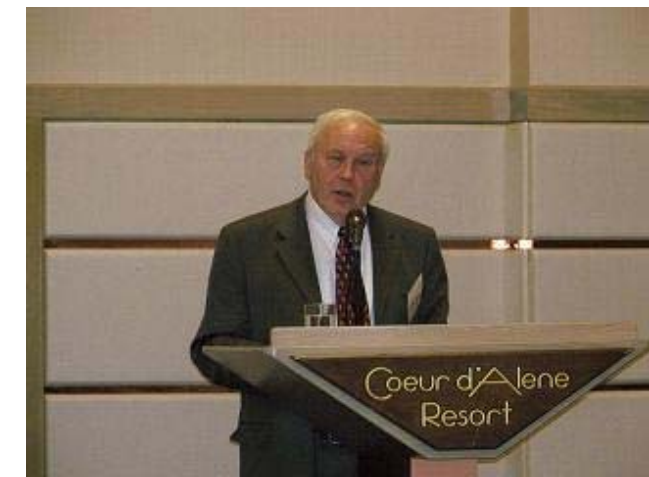
economic change on the insurance industry. He noted that the industry and regulation must change with the markets, with a need for greater uniformity and predictability. The Commissioner also said that three things need to take place: 1. Reforms in market analysis to make it more prospective in nature; 2. Simplification of producer licensing; and 3. Speed to market improvements.

Commissioner Joel Ario

Commissioner Ario recently left the Oregon department to take over at the Pennsylvania department. The Commissioner has held numerous leadership positions in the NAIC. He focused on a need to improve market oversight in ways such as streamlined licensing. He also noted that the federal and state governments are too focused on differences in regulation. The truth is that they work together on many things. If health insurance reform is to take place, for example, the states and the federal government must partner together to creatively solve problems.



Commissioner Kent Michie & Tom Considine



Director Tim Wagner

watched, so that it doesn't simply become the actuarial full employment act. A key factor is whether such reform benefits or hurts small and mid-sized companies. The NALC members need to continue to weigh in on this point.

Director Tim Wagner

Director Wagner spoke at length about problems in financial markets, including the growing role of hedge funds. With the emerging sub prime crisis, the FED must make certain that it doesn't act to reward those who took unnecessary risks. With respect to principles based reserving, the Director likes the idea of a carve out based on product types or company size. He also echoed Commissioner Ario's comments on the emerging issue of suitability. In fact, he commented that agents in Nebraska had complained to him that commissions were too high.

If health insurance reform is to take place, for example, the states and the federal government must partner together to creatively solve problems. Commissioner Ario believes that suitability and long term care are emerging issues for regulators.

Commissioner Kent Michie

Commissioner Michie noted that the average family pays more than \$12,000 per year for health insurance. Affordability is a major problem. The Commissioner is leading an effort in Utah to address this problem. The Commissioner also discussed federal regulation. He believes the most important point of discussion is who is better at consumer protection. On this front, he does not believe the federal government can match the aggressive protections provided by the states. The Commissioner also noted that principles based reserving must be closely



Commissioner Scott Richardson, Margaret Richardson & Tom Considine

Commissioner Scott Richardson

Commissioner Richardson was appointed several months ago by Governor Sanford. He served for a number of terms in the House and Senate of the South Carolina legislature. He also owned an agency in Hilton Head. The Commissioner discussed his focus on coastal insurance issues, as there is an access issue all along the east and gulf coasts. He also commented on the need for regulators to improve their marketing and public relations skills. Additionally, he commented that the legislators and regulators needed to put aside turf battles and work together to preserve state regulation.

Key Issues Facing Insurers in the Investment Process

Alton Cogert, President, Strategic Asset Alliance

The economy and financial markets pose interesting problems for insurers today. The U.S. economy is slowing because the residential real estate, credit, derivatives and leverage bubbles are all deflating or bursting. Residential real estate, like any levered asset class, is directly impacted by the availability of financing. The fact that \$20-50 billion per month of adjustable rate mortgages will be repriced at significantly higher rates will continue to cause problems for borrowers in meeting their obligations. When this is coupled with an earlier environment of easy credit due to nearly all players in the mortgage origination chain focused on production, one would expect a swiftly tightening mortgage credit environment and downward pressure on residential real estate prices.

More Risk Yet to Come

The amount of mortgage debt that is scheduled for its first interest rate adjustment is projected to rise sharply in the next few months.



Sources: Moody's Economy.com, Credit Suisse

Concurrently, this has caused a rethinking of the price of credit across numerous asset classes. Leveraged Buy Out (LBO) deals that were almost certain to be completed are now being rethought. Banks, the previous guardians of credit risk, have been able to sell their exposures either via leveraged loan sales or by buying 'protection' in the credit derivatives market.

Meanwhile, some of the most levered players in credit risk were shocked by the swift credit repricing. For example, if a hedge fund is levered 10:1, it only takes a 10% downward move to reduce the fund to rubble. Thus, hedge funds looked to delever by selling securities that were most liquid...and that includes those investment grade securities and equities typically found on insurer balance sheets.

Compounding this environment was fear of the unknown, as most of the players in credit markets do not have to provide much transparency, if any, in holdings and risk exposures. Thus, mutual trust quickly became mutual mistrust.

As noted in 'From the Northwest Quadrant', a blog on Strategic Asset Alliance's web site (www.saai.com), this has also played itself out in other ways. Only back in April, Fed Chair Bernanke was saying 'sub prime' mortgages would not be a problem for the rest of the economy. However, in September, the Fed dropped both the discount and fed funds rate a surprising 50 basis points due to their concerns. In July, S&P changed their model for rating mortgage backed securities, as the 'conflict of interest' inherent in their business model started to bite back at them. Also, in July, markit.com, a provider of index information on ABS (including sub prime mortgages) and CDS (credit default swaps) showed that 'A' rated sub prime tranches were now priced below typical Other Than Temporary Impairment triggers for write downs.



One big question is to what extent this financial market turmoil will impact the U.S. economy. And, thus far, we do not expect a recession within the next six months. Longer than that time frame, however, the future becomes cloudier to predict.

With all of these rough waters in the financial markets, it is probably time to review your company’s investment process in a calm, yet concerned manner. SAA utilizes the Investment Process Value Chain to view each part of the investment process and determine how an insurer can add value to the process.



In this review process, here are a few topics to make certain to discuss at this time.

Risk management is not just a buzz word any more, as A.M. Best is starting to ask questions (some of them embarrassing for some companies) about what they are doing in this area. Asset allocation and related decisions must be directly tied to risk management as well as overall corporate goals and objectives.

We fully expect credit risk to rear its ugly head in the coming years. Please remember that when you buy a corporate bond, you are, in effect, selling the issuer a put and collecting a premium (spread over Treasuries) for that option. The issuer, however, does have the option to default (exercise the put) and therein lies the essence of credit risk. Of course, with the repricing of risk from all of this market turmoil, we are now getting paid better for taking on that risk...but only for new investments.

We are starting to see some small and medium sized insurers get involved outside the traditional fixed income and equity asset classes. If your company has sufficient capital, you should at least consider such new asset classes within a disciplined asset allocation/risk management process.

As for the investment policy, we like to say that some companies are ‘sweatin’ to the oldies,’ using policies and guidelines that have not seen a material review for years.

Benchmarking investment manager performance is another key, as it both communicates expectations and measures performance against a passive alternative. Our advice on benchmarking: ‘raise the hurdle,’ since there are too many good choices in custom benchmarking not to do so.

In the world of investment manager search, many insurers are surprised to hear that there are several large managers that have started to focus on insurers. You do want to not consider what they have to offer, as well as the more traditional choices.

Meanwhile, the entire investment process must not be looked at in a vacuum. However, it should be designed to assist in meeting the company’s goals and objectives. For many companies, there has been insufficient success in tying the investment process and its metrics to the company’s key performance indicators of success.



Michele Kirsch, Cam Waite, Matt Reed & Sharon Reed

In these increasingly turbulent times in the financial markets, we think it is incumbent upon every insurer to carefully and conscientiously review its investment process.



Welcome to Idaho

Agent Debit Balance Management

Rick Dugger, President, Vector One

Rick Dugger founded Vector One in 1989 to help insurance companies manage relationships with agents who have a history of "company jumping," leaving debit balances in their wake. Vector One is the only central reporting vehicle that addresses this very specific debit balance information and makes it available to our industry. This is not public record information, and can only be obtained, by subscribers, from Vector One.

While Vector One's primary mission is to be a licensing and appointment tool, Vector One is also its subscriber's most effective means of recovering debit balances. In 2006, subscribers recovered in excess of a million dollars

from agents who paid their debit balance so they would be removed from Vector One. It's not often something as inexpensive as Vector One can save you thousands, if not tens of thousands of dollars a year.

There are 15-20 new agent records added every business day. Think of that: every business day. There are 10-15 agents removed every day, removed primarily because they pay what they owe. Additionally, more and more companies are using Vector One as an appointment renewal tool and before each advance. Clients constantly tell Vector One they recover more in debit balances than the small cost of Vector One, and that doesn't include the savings from avoiding an agent with a history of debit balances. Vector One is a profit center for its subscribers. Vector One is a very powerful tool for executives who are responsible for the bottom-line performance of agents. Vector One is due-diligence for the insurance industry.

Insurance Issues that Directly Impact Our States

Brian Patrick Kennedy, State Representative, Rhode Island

NCOIL – Vice President

Accreditation and Model Law Process:

Since the 1980's and early 1990's, legislators have stood up to the NAIC and its proposed sanctions of companies in unaccredited states. NCOIL has stressed the need for a 3-year exposure period in the states for prospective models since 1997, and that no model should become an accreditation standard unless it has **a cost-benefit analysis of proposed new standards and has been passed by the legislatures of at least 26 states.**

The NAIC has cut the NCOIL-proposed exposure period by collapsing it into one-year with procedures that have **weakened original language regarding estimates of cost for compliance and impact on states** with an additional caveat of "if reasonably quantifiable," and require a simple listing of the number of states that have adopted the model and their experience, without any mandate of a baseline number of states to pass models before being considered accreditation standards.



Representative Brian Kennedy & Director Tim Wagner

The NAIC claims the entire process to add standards to the accreditation process results in a five year process, however, two of those five years give legislatures no choice, since they are time given post NAIC approval in which states are expected to adopt the model to remain accredited. This means the process leaves states one year to expose a model after NAIC deems the model a potential accreditation standard.

The summer NAIC meeting in June was the first time a new model law framework, **which was adopted in a closed NAIC conference call in early May**, was applied to proposed NAIC model laws and amendments and this has resulted in confusion among many of the state's regulators.

Insurance Compact Commission:

The Interstate Insurance Compact Product Regulation Commission began operation in May 2006 and now has 30 member states representing half the insurance premium volume nationwide. The inaugural meeting was held on June 2006, and the first filings were received in June 2007. The next annual meeting is scheduled for September 2007 where the IIPRC will consider its filing fee structure to become a self-supporting organization based on filing fees and adopting uniform standards.

Since its inception, the Compact has required the support of legislators from the adopting states and commonwealths. The NCSL and NCOIL organizations have four legislative member appointments to the Compact Commission. We are awaiting the fourth and final slot to be filled by NSCL. All meetings are open to the public and the Compact represents a key state-based modernization initiative that benefits insurance regulators, consumers and the insurance industry by making insurance filings and regulation more efficient and effective in an ever-changing marketplace. The Compact will allow consumers to get access to more competitive insurance products more quickly, without restricting their remedies against insurers. Insurance companies will be able to make their product filings at a central point, thus avoiding duplicative filing procedures and allowing them to get competitive products into the marketplace without unnecessary delay.



Dawn Bergsma and Tom Powell

Currently 30 members have joined the Interstate Insurance Product Regulation Commission. The compacting members are: Alaska, Colorado, Georgia, Hawaii, Idaho, Indiana, Iowa, Kansas, Kentucky, Maine, Maryland, Massachusetts, Michigan, Minnesota, Nebraska, New Hampshire, North Carolina, Ohio, Oklahoma, Pennsylvania, Puerto Rico, Rhode Island, Tennessee, Texas, Utah, Vermont, Virginia, Washington, West Virginia, and Wyoming.

Optional Federal Charter

We are all aware that since the passage of the McCarran-Ferguson Act in 1945, that the regulation, oversight and consumer protection provisions for Insurance have rested in the hands of State government through the legislative process and the creation of insurance divisions that are run by regulators. Due to concerns about the ability of insurers to navigate through 50 different state insurance agencies in order to get a new insurance product to the marketplace more quickly, there has been an

effort to modernize insurance regulation in order to respond to changing market conditions. That was one of the goals of the Interstate Insurance Product Regulation Commission.



Friday Night Fun

Today, State insurance authority is under attack as legislation has been filed in both the United States Senate and Congress that would create an optional federal charter that would destroy the state system in place for generations and create a new potentially unwieldy federal bureaucracy. The legislation would allow Insurance companies to opt out of state licensing and oversight regulation which includes state consumer protection laws. There has been no widespread demand for this change. While many insurance companies are supportive of an optional federal charter, there has not been an request for this change from consumers.

The proposed legislation would compromise state guaranty fund coverage and most of all places state governments at peril since they derive general revenue dollars from the

regulation of insurance and collect over \$13 billion in premium taxes nationwide.

Summary

Legislators and the National Association of Insurance Commissioners have a common goal, which is to maintain a state-based regulatory system. Legislators should try to attend NAIC national meetings and it would be wise to more closely examine all proposed NAIC models that are brought before the state legislatures in the future.

Record Retention and Related Issues in the World of E-Discovery

Todd Newton, Attorney at Law, Mitchell, Williams, Selig, Gates & Woodyard

In December 2006, amendments to the Federal Rules of Civil Procedure went into effect, providing for the disclosure of “electronically stored information” in federal civil cases. These amendments apply to parties to litigation as well as third parties. In short, these amendments provide a framework for reciprocal discovery of information stored in electronic format which includes emails, voicemails, word processing documents, spreadsheets, etc. While the concept behind these amendments, i.e., the preservation and production of relevant evidence, is not new, these amendments clarify the responsibility that individuals and companies share: to preserve and disclose potentially relevant evidence when required to do so. In addition, the cases that have been decided since these amendments took effect illustrate that courts will not deal lightly with individuals or companies who fail to live up to their obligations.



Todd Newton, Rick Campbell & Eleanor Kitman

So, why should companies be concerned? Simply put, because the volume of electronic evidence today is significantly greater than traditional paper documents, as is the cost of reviewing and disclosing voluminous electronic evidence. A few statistics tell the tale: 90% of information being created today is in electronic form;

the average number of emails per employee per day is 25; larger corporations store backup information in terabytes (or 1 million megabytes). Given those sobering figures, there are two key reasons why companies should have *and enforce* solid record retention policies: (1) it's time consuming to review unnecessary data; and (2) it's expensive to do so. Unfortunately, the statistics also show that most companies do not have good retention policies in place, and many policies do not even cover emails.

There are numerous cases already on the books in which courts have handed out stiff sanctions for companies that have failed to abide by their own retention policies, failed to preserve potentially relevant evidence, and/or failed to produce potentially relevant evidence when obligated to do so. These sanctions have included fines, adverse instructions to the jury, and even default judgments. But it doesn't have to be this way. To avoid these types of scenarios, companies can (and should) take some simple steps to protect themselves, including: (1) creating and enforcing a solid record retention plan that includes both paper and electronic records, including a thorough inventory of all records created and maintained; (2) developing a litigation hold plan that prevents the destruction of potentially relevant information in the event of litigation, investigation, or audit, or the reasonable anticipation thereof; (3) establishing a discovery response team that can promptly locate, preserve, and produce potentially relevant information when the need arises; (4) designating an individual who can testify about the company's record retention plan and how it is enforced; and (5) educating employees annually about the record retention plan.



Welcome to Idaho

By taking time out now to plan for this type of event, companies can protect themselves from the consequences that will inevitably result from the failure to preserve and produce key evidence when the time comes.