



2009 Spring Conference Report

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



April 22-25, 2009
Hyatt Regency Coconut Point
Bonita Springs, Florida

The NALC held its 2009 Spring Conference April 22 - 25, 2009, at the Hyatt Regency Coconut Point, Bonita Springs, Florida. Following are summaries of presentations by participating speakers.

Commissioners Panel

***Kermit Brooks, Deputy Superintendent, New York
Thomas Hampton, Commissioner, Washington, DC
Jane Cline, Commissioner, West Virginia***

Kermit Brooks is First Deputy Superintendent for the State of New York. He spoke at length about the efforts to create a federal insurance regulator, and offered insight as a key regulator in charge of resolving the issues impacting AIG. Superintendent Brooks noted that skilled work on the AIG insurance issues were a fine hour for state regulators, as they worked closely together to protect the company and its insurance assets. Interestingly, the problems at AIG were not from its solvent, state regulated insurance companies. Rather, the problems arose from credit default swaps involving non-insurance activities of the company. These activities were not subject to state-or any other regulation. Brooks noted the rising importance of credit ratings agencies as shadow regulators, and the need for better communication between the credit ratings agencies and state regulators. He does not believe there is a need for federal regulation of insurance, and again noted the fine job state regulators have done in maintaining solvency of insurance companies.



Commissioners Cline, Brooks & Hampton



Commissioners Hampton & Cline

Tom Hampton is the Commissioner for Insurance, Securities and Banking of the District of Columbia. He is a leading the NAIC efforts to resolve Principles Based Reserving and Capital and Surplus Relief. He is also active in international insurance issues. With respect to Principles Based Reserving, he believes the project is near completion. Commissioner Hampton believe we need to move away from formulaic reserves and towards broad principles governing reserves. He noted the amount of back office time spent at his agency on reserving issues. He would

prefer that regulators focus more on back end review of company work.

Jane Cline is the West Virginia Insurance Commissioner and President-Elect of the NAIC. She discussed her early efforts to improve customer service at her agency and get control of insurance issues away from the courts and back to the agency. Commissioner Cline has been instrumental in moving the Interstate Compact through 35 states. She believes the Compact-with its focus on streamlining and timeliness-addresses the major issues raised by proponents of the Federal Charter. The Commissioner also noted the hiring of Terri Vaughan, former Iowa Commissioner, as the new Executive Director of the NAIC. Terri's credibility and knowledge will be valuable in responding to concerns raised in DC.



Governor Hodges Robert Chilton & Commissioner Cline

Federal Report

Ethan Sonnichsen

Ethan Sonnichsen is the new Government Relations Director of the DC office of the NAIC. In that capacity, he is dealing with issues like TARP funding, legislative and regulatory issues, the Optional Federal Charter, systemic risk regulatory concerns, and international issues. Ethan noted that single party control in DC makes it much easier to pass major pieces of legislation. With the big insurance groups spending over \$125 million a year in lobbying, they are clearly making a push to get the federal charter bill passed. Despite this effort, Ethan senses growing concern over the federal charter in Congress for the following reasons: inability of a federal regulator to deal with consumer issues, the scope of existing federally regulated financial ills, and inefficiencies of a federal regulator.

Product Development In Troubling Times

Leon Langlitz, VP & Principal, Lewis & Ellis

Jim Van Elsen, Senior Principal, Oliver Wyman Actuarial Consulting

While the economy is in a period that is not as robust as everyone would hope that it would be, companies need to be vigilant in maintaining their financial stability. Companies have faced asset problems, rating agency

actions, a drop in consumer confidence and disposable income, and changing technology. For these reasons the life insurance industry has focused to a large extent on maintaining strong balance sheets. For good reason they want to be sure to be able to withstand the economic forces that currently exist. However, a company needs to also look forward a plan for better times which are sure to come. Improved earnings should also be of concern, and one way to improve earnings is to issue new, profitable products.



Rick Campbell & President Kraus

Products should focus on needs, low complexity, with less emphasis on the need for projections, and use realistic pricing. Several ideas for products would include: “Non-par par” products, family coverage products, single

premium life, and immediate annuities. “Non-par par” products would have guaranteed premiums, provide possible excess credits and could provide for various riders. Family coverage policies would have the benefit expressed in terms of monthly income and could provide the benefit upon death, disability or unemployment of the insured. The third product could have adjustable death benefits, and other liquidity benefits. Annuities could combine immediate and deferred characteristics into one product. A series of shorter term annuities that build upon each other could also be developed.

Revised marketing materials that would support these products should focus on the company, allay consumer fears, stress the meeting of consumer needs, and focus on the true guarantees of the products. New technology should be used to reduce time for product issuing, improve the speed of compensation to producers, and probably provide more on-line resources.

Technology is also changing the communication a company uses to contact its consumers, distribution force, employees, regulators and investors. Social networking is becoming widely accepted and if used properly with the younger generation can provide a much needed boost to the company’s success.

In summary, while financial stability is paramount in the current economic environment a company still needs to look ahead and provide profitable products. Today, these products do not need to be complex, heavily dependent on unique features. Products that provide good guarantees for basic needs with good value to the consumer can be successful in today’s marketplace.

Outlook for the Life Insurance Industry 2009-2010

Terence Martin, Vice President, Conning & Company

“Troubled Waters”

Clearly, 2008 marks a dramatic change from the past for the world economy. Those changes started in the U.S. credit market during 2007, and initially the U.S. life insurance industry looked as if it might be spared the worst. Reality has proven otherwise.

Recent Life Industry Performance

Leading up to last year, the life insurance industry enjoyed several years of strong results between 2003 and 2007. Net premium on a statutory basis increased 23%. Statutory Operating Gain had been at historic high levels with strong operating margins. On a GAAP basis, the results were even stronger, with policy revenues increasing 50% over the five-year period and return on average equity for the industry an estimated 18%.

However, looking beneath the surface, this growth and profitability came with some increase in risk that was not immediately apparent under normal accounting principles.



Welcome to Bonita!



Life of Alabama Gang

- Separate account fees doubled over the period, but this fee revenue is not the low-risk revenue of the past. The new minimum guarantee features carry the underlying risk of having to contribute to customers' accounts to make up for falling asset values.
- Net investment income increased by more than the increase in underlying invested assets, but the allocation to equity investments also increased, especially allocations to common stock and Schedule BA assets, which represent alternative investments and private equity.
- Individual annuity premiums grew at a 4% annual rate, but net flows had been decreasing and were negative in 2007. This means that, despite the increase in sales, more money left the product overall than came in.
- The life insurance industry was highly leveraged. The ratio of assets to surplus remained about 10:1.



In 2008, many of these risks turned against the industry. Surplus took a massive hit, decreasing \$50 billion, even after \$52 billion of surplus being added from a variety of sources. The industry posted a statutory net loss of \$51.8 billion, driven by large realized capital losses on its investments.

Looking forward, future performance of the industry will depend on several wildcards:

- **Consolidation:** Companies with attractive strategic and operating characteristics—but short term financial strains—may be compelled to seek merger partners. However, availability of financing or capital to support a transaction may be problematic.
- **Reinsurance:** Demand for reinsurance may also increase as an alternative to the scarcity or high cost of other capital solutions, including bank lending, securitization, letters of credit, and the issuance of debt or equity.
- **The future of Variable Products:** Many of the guarantees on the market carry greater risk than previously understood, and hedging or other risk management solutions may continue to be tested throughout 2009. As the economy recovers, we expect separate account variable products will again take their place in the portfolio, though both margins and risk charges may be quite different.
- **Asset management:** If the current environment continues through 2009, investment departments will continue to be challenged.
- **Federal Regulation:** The debate appears to have changed from “If” to “When” and “How much.”
- **Innovation:** How will the insurance industry respond to the new environment?



Welcome Reception

These are certainly trying times, and the initial predictions of a “short and shallow recession” have faded away. However, the financial troubles are not evenly distributed. All companies have taken a hit, and most will survive, but the companies that were most prepared for these conditions will not only survive, but could even

thrive in this environment. There will be opportunities in the midst of the turmoil. Courageous companies will seize them.

It's all Politics: The Violent Crime Control Act of 1994 and the ongoing Debate over Federal v. State Regulation of Insurance

James Veach, Partner, Mound, Cotton, Wollan & Greengrass

Your program read: "The New Three Rs: Run-off, Regulation, and Reinsurance," but your speaker read his audience at the line of scrimmage and called instead for a discussion of why the Federal Insurance Fraud Statute -- *see*, 18 U.S.C. §§1033, 1034 -- arms U.S. Attorneys General with enough ammunition to influence the debate over federal v. state regulation of the "business of insurance."



Jim Veach, Michael Pouillot & Marco Bravo

Mr. Veach began with a look at both civil and criminal proceedings initiated by then Attorney General Eliot Spitzer and his then lieutenant, Eric Dinallo, against Wall Street investment banks and securities brokers using New York State's 1921 Martin Act. N.Y. Gen. Bus. Law §§ 352-c, 353 (McKinney's 1996). The Martin Act authorizes New York's Attorneys General to prosecute fraud involving securities bought or sold in New York State, but had rarely been used before Mr. Dinallo focussed on it. See, A. Paybarah, *Tutorial on Martin Act, Eric Dinallo*, <http://www.observer.com/2007/martin-act-tutorial>.

Attorney General Spitzer's investigations reshaped Wall Street and changed practices that Federal agencies had not bothered to investigate, much less try to change. See J. Cassidy, *The Investigation: How Eliot Spitzer humbled Wall Street*, THE NEW YORKER, April 7, 2003. These investigations propelled Mr. Spitzer into the Governor's office with the largest winning margin in New York state history and brought Mr. Dinallo to Beaver Street where Mr. Dinallo has distinguished himself as an effective advocate for state insurance regulation. See, for example, *Eric Dinallo: New York Insurance Cop.*, REACTIONS (February 2008 at 22) and Mr. Dinallo's articles in the FINANCIAL TIMES (LONDON), including, *Marriage, not Dating, is the Key to Healthy Regulation* (April 26, 2009).

The Federal Insurance Fraud Statute was enacted during the Clinton Administration as part of the Violent Crime Control Act of 1994. This Federal statute creates an exception to the McCarran-Ferguson exemption and allows any U.S. Attorney General using the broad jurisdictional authority granted under the statute to prosecute, among other things:

1. The making of any false statements in any insurance company financial report or document submitted to regulatory officials, be they state or federal; and
2. The knowing entry in any book, report, or statement of deceptive information about the financial condition or solvency of such business. 18 U.S.C. § 1033(c)(1)-(2).



Friday Night Fun

The statute applies to anyone engaged in the "business of insurance," a term broad enough to include not only insurers, agents, and brokers, but many of their agents as well, e.g., independent adjusters or even the designers of software used for insurance-related transactions. See, e.g., Beamer v. NETCO Inc., 411 F. Supp. 2d 882 (S.D. Ohio 2005).



Lisa & Summer Quist

e.g. United States v. Ferguson, 3:06-CR-137 (PCD) (Conn. Dist. Ct.) your speaker, a former prosecutor, believes that this federal statute may be a Martin Act waiting to be discovered. And any politically astute U.S. Attorney General who successfully prosecutes instances of insurance fraud that went undetected (or not prosecuted) by state regulators could influence future debate over the effectiveness of state v. federal, regulation of insurance.

Delivering Increased Producer Satisfaction Through Licensing Automation

Michael Pouliot, Senior Vice President RegEd Licensing & Registration Solutions Sales

RegEd's Michael Pouliot, Senior Vice President of Sales, presented on the administrative barriers to rapid, efficient producer licensing and what is possible today using state-of-the-art technology. Michael shared with NALC how lack of automation can cost a company up to two weeks in turn-around time due to deficient applications, result in costly compliance errors that are cited in audits, and give new producers a negative first impression of a firm's automation and administration.



Mr. Pouliot also presented what companies who have fully automated enjoy today. Licensing and Registration data is on the critical path for compliance, HR and new business acquisition. A fully automated L&R system can feed data to and from other business systems. It has seamless two-way data integration with regulators, real-time credentialing, just-in-time appointments, automated initiation of compliance transactions from business and regulatory triggers, and imaging and electronic storage of all data and documents. Current L&R systems mean rapid speed-to-market, near flawless compliance and a positive technology and service reputation in the marketplace.



Recipient Rob Hardy of 2009 Governors Award

The 2009 Governor's Award

The original Board of the National Alliance of Life Companies established an award to be presented periodically by the NALC to an individual who has

provided exemplary service to the NALC and shown long-time dedication to small life insurers in the life insurance industry in general. This award is called the Governor's Award.

Harry Lee Waterfield II presented Rob Hardy with the 2009 Governor's Award for his service to the NALC and the life insurance industry. Rob joins his grandfather, Harry Lee Waterfield, and his uncle, Harry Lee Waterfield II, in being honored for his service to the NALC. Rob has been present since the birth of the NALC, founded in 1993. Rob served as unofficial legal counsel and secretary framing up the new association.

We all know Rob as an active, contributing member to the work of our organization and industry. In fact, Rob served a two year term as President during the transition period after the decision to reject a merger with the LIC. During that period, he stabilized membership, helped educate a new Executive Director, and led an effort to resolve the Small Face Amount Disclosure issue at the NAIC. It is a measure of Rob's respect in the industry that he was chosen to testify for small insurance companies on the Optional Federal Charter bill before the U.S. Congress. Rob also served several years on the Preneed Committee and served as co-chair several years as well.

Congratulations Rob! Rob has put in a lot of hard work and valuable time resulting in great accomplishments for our NALC members.

The Gavel Award

Fred Meese presented the Gavel Award to Gerry Kraus in recognition of his leadership of the NALC during the past year. Gerry's many accomplishments include the recruiting of new members, the expansion of the small and specialty markets committee, and the adoption of the 1980 CSO Mortality Tables for preneed insurance products by the necessary 26 states. Gerry was also a key player in fighting back a proposal by the New Jersey Funeral Directors to its national association to ask the NAIC to pass a model regulation to restrict preneed insurance sales. We appreciate Gerry's fine service.



Recipient Kraus of 2009 Gavel Award

Save the Date...Mark your Calendars Now!

2009 Fall Conference



- The NALC will hold its 2009 Fall Conference September 30 - October 3 the Westin Kierland Resort & Spa, Scottsdale, Arizona.
- Online conference registration, the hotel reservation form, golf registration, tentative agenda and sponsorship will be available soon.