



2010 Spring Conference Report

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



NALC 2010 Spring Conference

April 14 -16, 2010
Kiawah Island Golf Resort
Kiawah Island, South Carolina

The NALC held its 2010 Spring Conference April 14-16 at the Kiawah Island Golf Resort, Kiawah Island, South Carolina. Following are summaries of presentations by participating speakers.

Scott Richardson

South Carolina Insurance Commissioner Scott Richardson covered a wide range of issues. He described successful efforts to bring automobile carriers back into the property and casualty residual market in South Carolina. As a result of market based reforms, South Carolina has over 150 insurance companies that are now competing in the market. The Commissioner also talked about a successful initiative to allow securitization of redundant reserves.

The Commissioner expressed concern over several federal initiatives. First, he opposes additional federal regulation of insurance. He believes federal regulation would be bad for consumers and business. The Commissioner also cited the implementation of high risk pools in the new Health Care Bill as an area of concern. He does not believe states can act within the limited time frame provided for in the law, which will result in the federal plan being the default choice. In his judgment, this will concentrate more decision making in the hands of the federal government.



Commissioners Scott Richardson & Jane Cline



Suzanne Loomis & Commissioner Tom Considine

Tom Considine

Commissioner Tom Considine of New Jersey spoke to the NALC. Mr. Considine was appointed Commissioner of Insurance and Banking by Governor Chris Christie. In the State of New Jersey, they have a \$13 Billion budget deficit on a \$29 Billion budget. This is creating serious governance challenges, including ways to cut the cost of government. The Commissioner mentioned entitlement reform (retirement health care costs) for teachers as one area of focus. Governor Christie is focused on making government in New Jersey leaner and more efficient.

The Commissioner mentioned several business related initiatives, including an effort to reduce the premium tax.

Additionally, his goal is to protect consumers from the excesses of government. In that light, he is moving forward on plans to create a market which is fair and flexible, and one which offers an array of choices to consumers at a competitive price.

With respect to the health care debate, the Commissioner feels the big issue that has not been addressed is the underlying cost of health care. Health insurance costs are impacted by the rising cost of health care, and the cost curve must be bent.

Jane Cline

Commissioner Jane Cline of West Virginia is also the President of the NAIC. Commissioner Cline focused on the role of state insurance departments in health care reform. One issue of concern is the adequacy of rates for the high risk pools. If the pools are to work effectively, the rates paid through premiums and/or subsidies must be realistic. She cited the West Virginia plan as an example, which allows for rates that are above market for high risk consumers in order to attract insurers. Without subsidy or adequate premiums, there would be no market. The federal government must recognize the need to address this problem.



Golfing at Sweetgrass

The Commissioner also mentioned the need to bend the cost curve on health care. In West Virginia, one health care system dominates the state, which makes it difficult for insurers to negotiate reasonable reimbursement rates for HMOs. She believes more needs to be done to drive health care costs down for reform to have an impact.

Charles Symington

Charles Symington, the federal legislative director for the Big I, spoke to the NALC. Mr. Symington has been involved in major issues impacting the insurance industry before Congress. He is also a member of the Board of Directors of COFIR.



Clarence Daugette, Rod Ross & Cam Waite

Mr. Symington mentioned that polls consistently show health care reform is unpopular with the public. Congress was able to defer some of the pain by delaying the impact of provisions like the tax on “Cadillac Plans.” The Big I was a big supporter of state based insurance exchanges, and was pleased that the final bill included such provisions. Mr. Symington did note that the exchanges will offer nonprofits an opportunity to offer policies for sale across state lines. Like other speakers, he expressed concern regarding the failure of the Health Care Bill to address major cost factors-like rising pharmaceutical and medical costs. The Big I is focused on efforts to keep the Financial Reform Bill from creating an expansive new Office of National Insurance.

What to Do in the Current Investment Environment

Andy Pace, Managing Director, Conning & Company

The last three years has been a rather extraordinary period of time in the markets. The end of a decades-long debt cycle and massive deleveraging event that began in 2007, had nearly catastrophic effects on the global



Paul Basile & Harry Bassett

financial system and economies. Efforts by government policy makers to stabilize the financial system, to arrest the deleveraging driven death spiral of declining asset values and diminished capital bases, and to offset sharp declines in private sector demand have driven massive increases in government debt levels. In addition, increased regulation and oversight, particularly for the Banking and Financial Services industries is underway and appears to be long lasting.

Numerous policy responses were initiated in response to the crisis and looking back over the last year or so, efforts to stabilize and re-liquify markets were quite successful. Credit

spreads on various US taxable fixed income sub sectors, as measured by the Barclays' bond indices, have moved back to pre-Lehman collapse levels and asset values have rebounded. For example the Barclay's Aggregate Index has returned 7.7% in the last 12 months, while riskier assets such as commercial MBS and junk rated corporate bonds have returned 43% and 56% respectively over this same time frame. While this has been great for historical total returns, compelling opportunities in today's bond market are much less abundant than they were back in the Spring of 2009.

Our 12 themes for the next 12 months, at this time, are as follows:

- 1) The current expansion hinges on business, not consumer spending.
- 2) This is a sustainable recovery (i.e. no double dip in our opinion),
- 3) The current monetary policy is dangerously accommodative.
- 4) The current fiscal policy is highly unstable and disruptive to investment.
- 5) Downside risks in this cycle will switch to inflation concerns by 2011, as a moderate but positive growth path for GDP takes hold.
- 6) Bond yields will continue to climb in late 2010 and 2011 with massive new supply, a diminished flight-to-quality premium, a falling dollar and an expanding global economy that should keep a bid on commodity prices.
- 7) The yield on the 10-year T-Note should remain range-bound (3.5 to 4.0%) through the end of 2010... 4.25 - 4.75% thereafter.
- 8) Next year begins a major flattening to the Treasury yield curve.
- 9) We still favor spread product over Treasuries, even though the rally in asset prices has moved ahead of the fundamentals - many sectors are just at fair value. We specifically like investment grade corporates, select BB-rated corporates, and A-rated and higher taxable munis (BABs) at this time.



Beach Birds

- 10) Diversification and issue selection are much more important than a year ago.
- 11) The seeds of secular change in policy makers' views on accepting higher inflation are taking hold perhaps. We believe the markets are not priced for this!
- 12) The markets likely to become less tolerant of delays in addressing cyclical and/or structural deficits by politicians.

The Benefits of Allocating to Private Fixed Income
Rick Long, VP/SR. Portfolio Manager, Aviva Investors
North America, Inc.

Privately placed fixed income securities, or “private placements”, are issued in the form of bonds and are exempt from registration with the Securities Exchange Commission (SEC). These transactions are generally investment grade quality and can be issued as traditional private placements or 144A securities. Private placements typically contain financial covenants and are more likely to be secured (20% to 25%) compared with public bonds (10%).



Ron Shortenhaus & Rick Long



Fred Meese, Ed Stephenson & Harry Lee
Waterfield

Private placements may be issued by both publicly traded and privately held companies domiciled in the U.S. or other countries. These companies issue debt in the private placement market for many reasons. Privately held issuers may not want to register their bonds with the SEC in an effort to keep their financial statements private. Other issuers prefer the private debt market because of the stability of the investor base or because the market is flexible regarding structures and maturities. Foreign companies issue in the private market because it is easy to access and allows them to diversify their investor base.

account in the asset class. The private fixed income market is a good compliment to a public bond portfolio for several reasons. First, private placements have consistently yielded 15 to 35 basis points more than similarly rated public bonds with the same maturity. The primary reason for the yield advantage is the premium paid for illiquidity, although there is an active secondary market for private placements. Second, private placements generally have a full set of restrictive covenants to which the borrower must adhere. Covenants provide an early warning system that allows the investor to know if a company is performing as expected. Third, the private fixed income market offers portfolio diversification both on an industry and on a geographic basis.

Insurance companies, the traditional investors in the private fixed income asset class, may invest 15% to 20% of general



Marilyn Hill, Lisbon Hardy & Lisa Quist



The Renfrows & Causeys

The traditional private placement market averages \$25 million to \$50 million in annual new issuance. In 2009, total issuance was \$26 billion. In 2003 to 2008, the median issue size was approximately \$200 million and the average number of investors per deal was ten. U.S. companies comprise 50% to 60% of issuers with the remainder coming from the U.K., Australia / New Zealand, Canada, and other European countries. The largest sectors in the private placements market are traditionally the utility, consumer non-cyclical and capital goods sectors. Issuance from the financial sector is substantially lower than in the public bond market. Private fixed income, in general, offers increased diversification opportunities by gaining access to issuers and

structures not available in the public bond market.

Private fixed income is a longstanding asset class which should be revisited by long-term investors. Investing in private fixed income is a back-to-basics strategy that can increase both current investment income and total return while substantially augmenting downside risk protection and portfolio diversification. We believe private fixed income is an important enhancement to long-term fixed income portfolios.

Restructuring Mechanisms, Solvent Schemes & NAIC White Paper. What This All Means for NALC Members

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

Mr. Veach took the conference attendees on a tour of the world of insurance (reinsurance) run-off using a recently approved White Paper from the National Association of Insurance Company (NAIC) as the guide. As he pointed out in his remarks, the world of insurance run-off is big: in 2008 at least 130 active U.S. insurers were in run-off with over \$36 billion in claims that must - eventually - be paid.

The NAIC White Paper - *Alternative Mechanisms for Troubled Companies* - began as an NAIC study of alternatives to traditional, state-court-supervised receiverships of which there are hundreds underway in all fifty states today. Concerned with the expense and delay associated with many of these receiverships, the NAIC commissioned a study of U.S. and U.K. alternatives.

Mr. Veach walked through U.S. alternatives to receivership, including:

- The regulator-supervised run-off of troubled entities that trip over a mandatory control level event as defined under risk based capital requirements, e.g., specific Illinois regulatory triggers;
- New York State's Regulation 141 that allows for a Superintendent-approved mass commutation plans that require the approval of the New York Superintendent of Insurance, plans that Mr. Veach has helped design and oversee for three troubled reinsurers; and
- Rhode Island's attempt to bring onshore the U.K.'s solvent schemes of arrangement through Rhode Island legislation that permits the voluntary restructuring of certain solvent insurers.



Terri Kraus & Lee Waterfield

Your speaker then compared these U.S. mechanisms with the U.K.'s solvent scheme procedures under the U.K. Companies Act and Part VII transfers of reinsurance assets and liabilities to another reinsurer. Part VII transfers move reinsurance assets and liabilities (usually within the same insurance group) without policyholder approval/novation.

To enliven the discussion, Mr. Veach reviewed the political ramifications and repercussions that accompanied (and shaped) the White Paper, specifically its elaborate lists of advantages/disadvantages for each of these alternative devices.

Summary of Solvency Modernization Initiative

Jim Binder, Vice President Corporate Strategy, Jackson National Life Insurance Company

1. Articulation of the U.S. solvency framework and principles.
2. Study of other sectors' and other countries' solvency and accounting initiatives and the tools that are used and proposed.
 - Internal Models for setting capital.
 - Enterprise Risk Management as part of governance.
3. Creation of a new reinsurance regulatory framework.
4. Movement to principle-based reserving for life insurance products.
5. Enhancement of group supervision.
6. Ultimately, implementation of new ideas to incorporate into the U.S. solvency system.



Jim Binder & Brian Casey

Save the Date!

2010 Fall Conference

September 22 – 24, 2010
Stoweflake Resort
Stowe, Vermont

- The NALC will hold its 2010 Fall Conference September 22 – 24, at the Stoweflake Resort, Stowe, Vermont.
- Online conference registration, hotel reservation information, golf registration, and sponsorship information will be available soon on the [NALC website](#). You will have the option of registering online, or completing the forms on your computer.



Watch your e-mail for Conference updates and reminders!