



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



Spring Conference Highlights

The Lodge at Rancho Mirage
Rancho Mirage, California
April 6-9, 2005

The NALC held its 2005 Spring Conference April 6 - 9, 2005, at the Lodge at Rancho Mirage, Rancho Mirage, California. Following are summaries of presentations by participating speakers.

Thursday, April 7

Commissioners Panel

- *Chris Corbin, Deputy Executive Director, Kentucky Office of Insurance*
- *Walter Bell, Commissioner, Alabama Department of Insurance*
- *Jim Poolman, Commissioner, North Dakota Department of Insurance*
- *John Oxendine, Commissioner, Georgia Insurance Department*
- *Ernie Csiszar (Former Commissioner), President & Ceo Property and Casualty Insurers of America*



Ernie Csiszar and Chris Corbin

The NALC received an excellent presentation from its Commissioners Panel. The panel included Chris Corbin, the Deputy Executive Director of the Kentucky Office of Insurance. Deputy Director Corbin discussed a variety of measures pending before the legislature in Kentucky. He also talked about the benefits of state regulation. He is greatly concerned that efforts to transfer authority over insurance regulation to the federal government would be more costly, less efficient, and less responsive to consumers.



Commissioner Bell, Loresa Bell & Commissioner Oxendine

Commissioner Walter Bell of Alabama made a presentation. Commissioner Bell discussed three big challenges facing the industry and regulators. First, he noted that the Small Face Study Group had completed its work, and was ready to present a proposal at the Life A Committee meeting in Boston in June. He indicated that he supported the proposal, and urged the industry and consumer representatives to do the same. Next, the Commissioner talked about federal regulation of insurance. The SMART Act includes too much mandated preemption, but he is concerned that the optional charter alternative looms in the background. Commissioner Bell believes that passage of the Interstate Compact in more states would help solve many concerns, particularly those complaints which relate to the timeliness of product approval. Finally, the Commissioner noted that the Marsh and AIG matters raised a whole new set of

corporate ethics issues that must be addressed. In particular, he is searching for a new and improved Sarbanes Oxley regulation for companies, which would provide greater transparency and disclosure, without some of the undue burdens of Sarbanes Oxley.



Commissioner Poolman & Commissioner Oxendine

Commissioner Jim Poolman of North Dakota spoke about Sarbanes Oxley, federal regulation and the Small Face issue. He opposes extension of Sarbanes Oxley to non-SEC filers as burdensome and unnecessary. Commissioner Poolman also spoke in favor of state regulation. The Commissioner has been the leader of the Small Face Study Group for the past several months. In that capacity, he has worked with industry, regulators, and consumer representatives to reach a resolution of the various proposals. With the help of Rob Hardy and the NALC, it appears that a compromise has been reached that enjoys broad support. The Commissioner indicated that if the resolution passes at the NAIC meetings in Boston, the Small Face issue will not be revisited by the NAIC in the foreseeable future.

Commissioner John Oxendine of Georgia also made a presentation to the membership. Commissioner Oxendine talked about the need to clearly distinguish between brokers and agents in the discussion of broker disclosure at the NAIC. He also noted that the various federal regulatory proposals pending in Congress would be harmful to consumer and industry interests. Commissioner Oxendine has been a national leader in the effort to investigate business practices of insurance agents and companies that focus on military sales. A number of other states are now following suit. Finally, the Commissioner indicated his belief that the Sarbanes Oxley discussions at the NAIC were premature.

The final speaker was Ernie Csiszar, the CEO of the Property and Casualty Insurers Association of American (the PCI). Mr Csiszar was most recently Insurance Commissioner of South Carolina and President of the NAIC. He noted that the PCI supports the SMART Act, and is concerned about the tone of the exchange between the NAIC and Congressman Oxley. Rate relief or deregulation must be included in the Act for PCI to continue its support. Mr. Csiszar did note concerns about federal regulation, including the potential that insurance would become a national entitlement, the potential for a single regulator to put the industry out of business, and the possibility that federal regulation would beget more regulation.



Cam & Yvonne Waite, Jim Hodges

Friday, April 8

Life Insurance - Class Actions Affecting the Life Insurance Industry

Markham Leventhal, Partner, Jordan Burt, LLP

Markham Leventhal, a litigation partner at Jordan Burt LLP, gave a presentation summarizing the different types of class actions affecting the life insurance industry and the nature of the claims or conduct typically giving rise to class action claims. The presentation included distribution of a paper summarizing the important class action decisions and legal developments in life insurance class action litigation over the past year.

Significant class litigation against the life industry began in the early 1990s with so-called “vanishing” premium class actions. Over the past 10 years, national networks of class action plaintiff lawyers have developed, many who now have extensive experience filing suits against life insurance companies. These lawyers use websites and Internet technology to market themselves and to solicit policyholder clients on a national basis. They have developed a host of different theories over the years and new theories of liability are always being developed.

The types of class action litigation filed against life insurance companies include “sales practices” class actions, “gap premium” class actions, “modal premium” class actions, long term care (“LTC”) class actions attacking marketing practices and/or rate increases, “cost of insurance” class actions, cases involving corporate owned life insurance (“COLI”), industrial life class actions involving claims of racial discrimination, “premium tax” class actions, class actions involving variable life and annuity products, traditional securities class actions, dividend class actions against mutual companies, “market timing” class actions, and recent “contingent commission” class actions. Many court decisions relating to these types of class actions have been decided over the past year. A copy of the paper discussing these decisions is available upon request.



Bob Baculik, Kay & Michael Lowe



Life Insurance Company of Alabama “Family”

Class action claims can arise out of a variety of different types of conduct including allegations of misleading or deceptive sales practices, misleading marketing or advertising materials, misleading illustrations, unclear or ambiguous contract language, mismatching between premium and benefits or coverage, lack of adequate disclosure, suitability issues, replacement of policies, regulatory violations, rate increases, adjustments in fees or expense charges, interest or dividend crediting, and computer or human errors in contract processing or administration.

Recent developments in the contingent commission area include several new class actions against brokers and life insurers arising out of group life and disability business sold to employee benefit plans. These cases allege “steering” of customers, failure to disclose contingent compensation, breach of fiduciary duty, and conspiracy between brokers and insurers. Class action litigation in this area is just beginning, and new theories and cases will be developing. Efforts by some regulators to dissolve the distinction between brokers and agents and to impose broad fiduciary duties owing from all agents to consumers would be a boon to plaintiffs’ lawyers and would proliferate substantial litigation and vicarious liability against the industry.



Harry Lee Waterfield, Lynn Lowe, Rob Hardy

Sarbanes Oxley

Larry Johnson, Assistant VP of Operations, Investors Heritage Life Insurance Company



Ed Stephenson & Larry Johnson

The NAIC continues to press for the adoption of Sarbanes-Oxley provisions, including the Section 404 internal control reporting requirements, for all insurance companies. While Sarbanes-Oxley continues to be heavily discussed within the NAIC, insurance companies should begin preparing for the possibility of Section 404 reporting. During the NALC Spring Meeting, Larry Johnson, Assistant Vice President of Operations for Investors Heritage Life Insurance Company, gave attendees an understanding of the intricacies of Section 404 via discussion of his experience in implementing Section 404 in a small company environment.

The presentation focused on the requirements of Section 404, the framework used in developing management's report on internal control, the auditor attestation process, challenges in the process and the keys to success. Currently, the recognized framework for internal control reporting is the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") Internal Control – Integrated Framework. This framework does not differentiate among companies based on size or complexity, although the Securities and Exchange Commission is considering potential changes to Section 404 to enhance its effectiveness in a small company environment.

To satisfy the Section 404 reporting requirements, management must consider all significant financial reporting aspects of a company's operations, including the effectiveness of senior management and the tone they set within the organization. Ultimately, both management and the external auditor must test the key controls over financial reporting in order to validate management's assessment of the internal control environment. Potential reportable items include those items identified as "significant deficiencies", which are reportable to audit committees, and "material weaknesses", which are discussed in and affect the external auditor's opinion on management's assessment of their internal control environment.



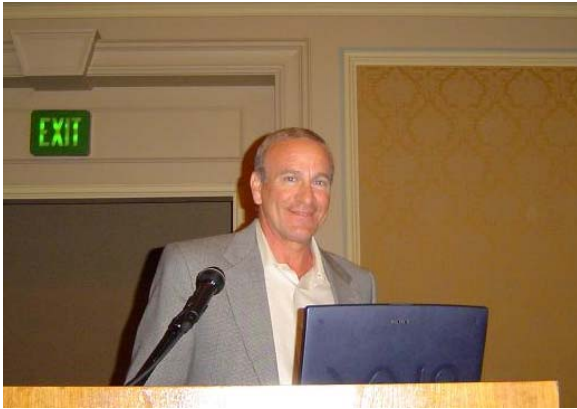
Friday Night "Fun"

The most significant challenges facing small companies in the process include the significantly increased external audit and potential third-party consulting costs, the lack of internal resources, an inability to perform independent controls testing, the somewhat different interpretation of the requirements among various external auditors, and the effect of this increased work on normal strategic operations.

Mr. Johnson has made available several documents related to his presentation, including E&Y's 404 series (books 1-4), Perspectives on Internal Control Reporting, An Investor Resource Guide, and Section 404 Post Implementation Guide. These documents are available through the online version of this newsletter at <http://members.nalc.net>.

Reinsurance - What Next?

Philip R. Kruse, Executive Vice President, Max Re LTD.



Phil Kruse

There has been significant growth in life reinsurance in the U.S. over the past ten years, and most significantly over the past five years. This is nicely documented by looking at the amount of new business being reinsured as reported by the Society of Actuaries, the increasing amount of in-force business (a five fold increase from 1994- 2003) \$216 billion in new sales face amount in '94 increasing to \$1,057 billion in 2003.

Overly conservative reserving requirements, primarily on level term policies, and the marketing of attractive reinsurance rates, influenced by the effects of significant levels of mortality improvement are the major drivers of this growth. Adding to this growth has been the increasing acceptance among a

significant part of the life industry to cede ever increasing amounts of risk to the life reinsurance market.

The past ten years has also been marketed by significant structural change in the life reinsurance industry. There have been eight major acquisitions over the past eight years, more than likely this wave of consolidation is still not over. This consolidation coupled with the growing dependence of primary insurers on cost-effective reinsurance, has created the conditions for what some are saying is the first hard market for life reinsurance in perhaps a generation. While higher reinsurance costs are probably a foregone conclusion, new entrants are coming to the market, and new techniques including securitization are gaining greater acceptance, all of which will more than likely limit the extent and duration of a harder life reinsurance market.

Trends in Insurance Regulation

Ann Henstrand, VP Financial Industry Services, Multistate Associates

After spending two days listening to an extremely well-informed series of commissioners, former commissioners and industry experts share their views and insights on important issues before the NAIC and state insurance departments that will change your businesses and cost you money, I've decided to try to garner some distance by sharing some more conceptual observations on common themes I see, which may help us understand how we got here, and where we're going. I've boiled it down to three areas (which I've given funny names to) -- shifting players, opposites attract, and newly discovered strange forces.

First of all, **'shifting players'**...there are always changes in the ranks of the commissioners from one year to the next and the political mix can reflect shifts in party control in some states. The swing in the statehouses toward GOP control has meant an increasingly red-state NAIC at the commissioners tables. Any time the NAIC falls somewhere north of a 70-30 split in political philosophy in either direction, the debates becomes more polarized, and compromise more elusive. Moreover, at the NAIC, some significant individuals are gone, or in different roles: Norris Clark, the godfather of statutory accounting; Larry Gorski, Illinois actuary par excellence and father to much of modern investment oversight; Ernie Csiszar, the voice of reason and rational approach to the business of the NAIC for more than 5 years, now leading the new PCI; Terri Vaughan, possibly the smartest commish ever, godmother of the interstate compact, went back to academia; Greg Serio, now working with Al D'Amato's



Tom & Susan Powell

firm; and an election change in Michigan and then the sad untimely death of Frank Fitzgerald, who had just stepped down from the Commissioner's seat due to the election of a Democrat to the Governors office. Frank was very influential in early development of CARFRA, leading to interstate compact – a charge later picked up by Alabama Commissioner Walter Bell.



The second theme I've identified is what I call '**opposites attract**'....continual tensions are increasingly pulling policymakers and companies in completely different directions – black and white – hot and cold. The tensions are acted out again and again, and the feelings are so fierce on both sides that there is no apparent middle ground, and other issues with seemingly less gravity and force get swept in to the mix by the strength of these positions/nexuses. Of course, there have

always been two sides to the policy questions faced by state regulators, but the differences have never been as stark. On either side these days are the supporters of federal regulation versus state regulation; at the NAIC there is the now thoroughly institutionalized consumer liaison and industry liaison committee meetings, held not to make any decision at all, but used for posturing and sensationalizing issues, and, finally, the opposite pulls between the Sarbanes-Oxley move toward suspicion of big business, and, the GOP-driven move toward greater and greater deregulation. So where do all these tensions lead? Not toward the center.

Finally, the last of my three themes – the influences of several '**newly discovered forces**'...New York State Attorney General Elliot Spitzer is just the tip of the iceberg of the increasing politicization of highly technical policy issues. The investigations are having a corrosive effect not only on our industry's reputation, but are serving as an idea factory for the trial bar, and leading to dangerously reactive posturing in state legislatures. The next strange new force in the insurance regulatory world is the SEC – newly pressured to act in the wake of Enron and SOX, but acting reactively not proactively, and blurring the insurance/securities line further. Finally, FASB – Financial Accounting Standards Board is an important new influence in this world, post-codification of statutory accounting any move made by the FASB is automatically and immediately fed into statutory for evaluation and possible adoption.

These three areas of influence are new. They were not in play five or ten years ago. If companies such as the small and mid-sized NALC members are to maximize their effectiveness at protecting their ability to do business, then it is important to understand these changes.

Senior Life Settlements

Roger Annin, Senior VP & Principal, Lewis & Ellis, Inc.

The senior life settlement market has expanded dramatically over the past couple years and is expected to reach \$12 Billion to \$15 Billion of face amount placed during 2005. Various statistics show the market may have hit \$10 Billion placed last year and this is up from just \$3 Billion a couple years ago.



Art & Linda Fess

The purpose of this talk is not to judge the senior life settlement market, but simply to admit it exists, is growing and affects our industry. As such, it is important for us to have an understanding of how the market works and why growth has been so dramatic.

Senior life settlements include policies written on people who are now at attained ages of 65 to 70 or over. Generally, policies with face amounts of \$250,000 and over are most attractive in this market and often, the market focuses on \$1,000,000 policies and over. Policies must be past the contestable period and generally, must be written by a company rated B+ or higher.

In the simplest terms, agents provide most the policy leads for this market by working with providers who buy the policies, bundle them and then resell to investors. In acquiring the policies, an independent underwriting agency will be employed to evaluate the life expectancy of the senior. Ideally for the market, life expectancies of 4 to 10 years are preferred. At these attained ages, these are impaired lives, but not viatical cases (wherein the life expectancy would be 2 years or less).



Based on the life expectancy, an offer is made to the policyholder. Most policies are universal life (UL) or term insurance policies. For the UL plans, benefits are generally underfunded, meaning that the policyholder faces increasing COI charges and high costs to retain the policy in-force. As such, many policies are purchased from insureds who had planned to allow the coverage to lapse for minimal or no value. This explains in part the rapid growth in the market as policyholders are able to get 20% to 25% of face amount for policies they felt had little or no value.

Investors will use mortality assumptions based on the life expectancies to purchase blocks of business. Typical yields to investors are 15% to 20%, an excellent return in the current economic environment. Surety bonds priced to remove the long term risks make this an investment that can be packaged very much like a private placement bond with defined term and principal protection.

Lewis & Ellis, Inc. is active in evaluating this market and has developed special tools for this work. We see opportunity for smaller life companies to supplement their investment returns through specially designed investment packages of contracts, which might perform much like CMO's do for the mortgage market.

Again, this is an important market that has shown tremendous growth. It presents both challenges and opportunity to those willing to examine the market.

NALC Leadership Change



Rob Hardy & Fred Meese

Leadership of our organization has passed into the hands of Fred Meese of Great Western. Fred is already off to a great start, and we are fortunate to have him.

We are also blessed to have had a terrific leader for two and a half years in Rob Hardy of Investor's Heritage Life Insurance Company. Rob took over the leadership role in a difficult time. During his tenure, we hired a new Executive Director, increased membership, cut operating expenses, and successfully fought proposals to cap premiums on small face policies. Rob proved he was not only a champion on the basketball court, but in the boardroom as well. Thank you, Rob!