National Conference of Insurance Legislators

NCOIL ETTER

...for the states

February 2009 www.ncoil.org

NCOIL LEGISLATOR TO HOUSE COMMITTEE: STATES SHOULD REGULATE CREDIT DEFAULT SWAPS

NCOIL Financial Services & Investment Products Committee Chair Assem. Joseph D. Morelle (NY) called for state credit default swaps (CDS) regulation—testifying on February 4 at a U.S. House Committee on Agriculture hearing that CDS are "species of insurance" and "best left to the regulatory purview of the states."

Speaking on the second day of a two-day hearing to review a draft *Derivatives Markets Transparency and Accountability Act of 2009*, circulated by Committee Chair Rep. Collin Peterson (D-MN), Morelle said in his testimony that the discussion has "implications beyond even the very broad horizons of its specific subject matter, for it relates to our fundamental notions of the free market system."

Morelle said that NCOIL—in recognition of this and particularly in the wake of AIG's near collapse—had turned attention to examining what manner of financial instrument CDS are and to considering how to hold CDS to the same safeguards as similar financial products.

Claiming that CDS authority must accrue to the states, Morelle said the 2000 *Commodities Futures Modernization Act* (CFMA) wrongly preempted state CDS oversight and allowed "so-called 'naked swaps'—those CDS contracts that are speculative in nature and are merely directional bets on market outcomes—to proliferate to the point where they now constitute 80 percent of the CDS market…with no regulatory framework."

Morelle, one of 15 witnesses, discussed a January 24 NCOIL CDS hearing in New York City. He said states could regulate CDS via a compact or model law that would create strong solvency and reserving requirements to prevent future crises. He said NCOIL, working with the states and NAIC, could provide required expertise.

NCOIL will chart a formal policy course at its Spring Meeting in Washington, DC.

STATE NEGOTIATES CONTROVERSIAL MEDICAID POLICY

In a controversial move that could revolutionize state Medicaid policy, Rhode Island Governor Don Carcieri made a unique deal with the Centers for Medicaid and Medicare Services (CMS) that took effect last month. The agreement —which is commonly referred to as a "global Medicaid waiver"—is a first-of-its-kind partnership that gives the state broad authority to manage its Medicaid program in exchange for an aggregate $12.4 billion spending cap for the next five years.

Supporters of the waiver think the move will give the state needed flexibility to best address its elderly, low-income, and disabled while improving both the quality and delivery of the state's health-care system.

Critics, however, (continued on page 4)

NCOIL has the honor of welcoming **Ethiopis Tafara**, director of the Securities and Exchange Commissions' (SEC) Office of International Affairs, as keynote luncheon speaker during the NCOIL Spring Meeting in Washington, DC. The luncheon will take place on Friday, February 27, from 11:45 a.m. to 1:15 p.m. at the Hyatt Regency Capitol Hill.

Preserving State Insurance Regulation...

- By interacting with Congress on issues of critical importance to insurance public policy
- By educating state lawmakers on the solutions to their insurance-market crises
- By fostering relationships between state legislators
- By asserting the primacy of state insurance regulation under the McCarran-Ferguson Act of 1945

Inside This Issue:

View from the Hill: Congress, Treasury on the Move 2

Group Says Hold Federal Dollars Hostage to State Auto Safety Laws 2

Point/Counterpoint: Ease Life Insurer Capital and Surplus Requirements? *ACLI versus Consumer Federation of America* 3

© 2009 National Conference of Insurance Legislators

VIEW FROM THE HILL: CONGRESS, TREASURY ON THE MOVE

The first two weeks of February were like something from the *Wizard of Oz*: Members of Congress faced head-on the unknowns of an economic stimulus package, regulatory reform, and a new Treasury financial plan…oh my! Lawmakers compromised on an almost $800 billion economic stimulus bill, the Senate Banking Committee heard from economic experts on regulatory reform, and recently confirmed Treasury Secretary Tim Geithner unveiled a *Financial Stability Plan* to strengthen financial institutions and ease credit markets.

The Senate Committee first heard from Group of Thirty (G30) Chairman Paul Volcker and Acting Comptroller General Gene Dodaro about recent G30 and GAO reports on financial modernization. The reports identified regulatory gaps and weaknesses and called for comprehensive financial services reform, among other things. While Committee Members and witnesses alike focused on a federal-first approach, Senator Mike Johanns (R-NE), a former Governor, said that with state insurance regulation, there was "a closeness of regulation that never got too far away."

While Committee Members and witnesses alike focused on a federal-first approach,…a former Governor said that with state insurance regulation, there was "a closeness of regulation that never got too far away."

Secretary Geithner—fresh from introducing the Department plan to the nation—briefed Senators on its details, including efforts to require "stress tests" of financial institutions, clear bad assets from company financial portfolios, and encourage consumer and business lending. Replying to comments from Sen. Tim Johnson (D-SD), the Secretary said that an OFC may be "an important part" of a regulatory reform plan.

The Secretary's remarks drew a strong, quick response from NCOIL legislators, who in a February 12 letter advised Secretary Geithner against pursuing an OFC. A federal charter, they said, would bifurcate insurance regulation and perhaps cost states billions of dollars in revenue that otherwise could fund infrastructure and education projects, among other things.

With the economic stimulus package behind them, Congress and the Administration will focus on broad regulatory reform. First up: defining and creating a "systemic" risk regulator. Will it be Oz's voice behind the mighty curtain?

HOLD FED DOLLARS HOSTAGE TO STATE AUTO SAFETY LAWS, REPORT SAYS

Sensing that the time is right for bold federal action—and frustrated by a "nationwide stagnation" in state adoption of auto safety laws—the Advocates for Highway & Auto Safety last month called on Congress and the President to force state uniformity by threatening to withhold federal highway construction dollars.

The organization, which is a self-described alliance of consumer, health and safety groups, and insurance companies and agents working to make America's roads safer, said in its new *2009 Roadmap to State Highway Safety Laws* that legislatures' inability to pass tough restrictions will lead to unacceptable and unnecessary deaths—and that federal leadership must "break the gridlock." According to the report, "While some elected state representatives and governors have tried to push passage of safety laws, the pace is too slow, the political obstacles too large, and the problem too great to wait 10, 20, or 30 more years when millions of lives are affected."

Strong federal intervention is not unprecedented, the study says. A 1984 National Minimum 21 Drinking Age law, as well as both 1995 and 2001 federal laws on blood-alcohol content, all used federal highway funds as a hammer to force state compliance. Not one state, the *Roadmap* reports, lost its federal money.

The Advocates' study also ranks states on their laws—or lack thereof—regarding adult occupant protection, child passenger safety, teen drivers' licenses, and alcohol-impaired driving, among other things.

POINT-COUNTERPOINT: EASING CAPITAL AND SURPLUS RELIEF REQUIREMENTS

Responding to today's financial turmoil, the life insurance industry has asked the NAIC to ease capital and surplus relief standards that insurers say unnecessarily tie up capital . The NAIC has rejected the plan, but states are taking their own action. The writers below answer the following: Should states ease capital and surplus requirements for life insurers? Why or why not?

Unfortunate Decision by NAIC on Capital and Surplus Relief Proposals

By Paul Graham

ACLI believes that the recent decision by the NAIC to reject the recommendation of its Capital and Surplus Relief Working Group concerning targeted reserve, risk-based capital, and accounting changes was not in the best interest of insurers, regulators, and consumers alike. Excessive reserve and capital requirements can have the effect of harming the very companies that reserve requirements are designed to protect.

Excessively conservative standards give consumers an inaccurate picture of insurers' financial health and may lead consumers to make poor choices, such as surrendering policies with large surrender charges. Even more unfortunate, many of those choices may result in insurers taking actions that aren't in the best long term interest of their policyholders. For instance, insurers may be forced to sell long-duration assets at extremely depressed prices to meet liquidity needs or lay off employees to generate positive cash flows. These actions are irreversible. Once done, the economic value given up is gone forever.

Regardless of the outcome of the NAIC's deliberations, the life insurance industry remains strong. The various capital and reserve changes that ACLI asked the NAIC to consider were never intended to prop up failing companies, but rather to help preserve financial flexibility for companies with significantly more capital than that required by law. The suggested changes were targeted. Many of them would simply apply today's standards to older blocks of policies issued on outdated standards developed more than a half century ago—which don't work well with new product designs.

It should be noted that the NAIC didn't reject the proposals on their

(continued on page 4)

Proposed Capital and Surplus Plan Wrong for Consumers

By Bob Hunter

At the hearing NAIC held on the ACLI proposals it was clear that NAIC had not done the impartial research needed to know if life insurer reserves, capital and surplus are excessive or inadequate in the aggregate.

ACLI will claim that the specific nine items they picked for the NAIC to consider contain some redundancies. But the list was chosen by ACLI with the objective of lowering the dollar cushion that protects consumers. We know this because ACLI admitted that, although some other items result in inadequate dollar cushions, they were not on ACLI's list for reform.

I asked the ACLI witness about this quote from the *Washington Post*: "Regulators have alleged that some insurers have been using a dubious accounting maneuver involving reinsurance to improve their capital position. Sheldon Summers, chief actuary at the California Department of Insurance, said the procedure, which involves such esoteric concepts as 'deferred premium assets,' accounted for at a least a third of the excess of one company's assets over its liabilities." (*Life Insurer's Take a Hit*, Hilzenrath, January 24, 2009) My question was simple: why did ACLI not include changes like the deferred premium assets that cut the other way when needed and raised the dollar cushion to better protect consumers? ACLI's witness said this should be done but, of course, there was no emergency action to achieve that.

Further, the NAIC's expedited process for consideration of the ACLI proposals was deeply flawed. ACLI met with NAIC in closed meetings. NAIC did not make the proposals known to the public until forced to do so by consumer pressure.

Secret votes were

(continued on page 4)

"Excessive... requirements can have the effect of harming the very companies that reserve requirements are designed to protect."—ACLI

"...the list was chosen by ACLI with the objective of lowering the dollar cushion that protects consumers."—CFA

Unfortunate (cont. from pg. 3)

merits, but rather due to concern that the current environment did not rise to the level of "emergency," and that the changes could be made during the due course of 2009 business. ACLI is encouraged to hear that the proposals will be reconsidered for adoption for this year.

Paul Graham is VP, Insurance Regulation and Chief Actuary with the American Council of Life Insurers (ACLI).

Proposed (cont. from pg. 3)

taken. Our basic questions on implementation, cost and industry-wide impact, as well as on the impacts to individual insurers and products, were not answered.

While a case might sometime be made to ease the capital and surplus requirements, it has not happened yet. NAIC was right to vote the proposals down.

Bob Hunter is Director of Insurance with the Consumer Federation of America (CFA).

STATE (cont. from pg. 1)

consider the move too risky during an economic downturn—when spending might easily exceed anticipated levels—and say the new system could limit options for the state's most vulnerable populations. If the state exhausts funds before the five-year mark, it will lose federal contributions and be forced to pay program costs in full or cut services.

In response to consumer concerns, the RI General Assembly has introduced legislation that would require lawmakers to approve any significant change to state Medicaid benefits, eligibility, and cost sharing requirements before the change took effect. The legislation has passed the House and is under consideration in the Senate.

The state can opt out of the CMS agreement with six months prior notice or if faced with a catastrophe, such as an epidemic.

NCOILetter

Susan F. Nolan, Publisher/Editor

Candace Thorson, Managing Editor
Mike Humphreys, Associate Editor
Jordan Estey, Associate Editor

Simone Smith, Production Assistant
Laurie Dingmon, Business Manager

Opinions expressed in the *NCOILetter* do not necessarily reflect the views or opinions of the National Conference of Insurance Legislators. The *NCOILetter* is published monthly by Nolan Associates.

D.C. Office:
601 Pennsylvania Avenue N.W.
Suite 900, South Building
Washington, D.C. 20004

National Office:
385 Jordan Road
Troy, NY 12180

NCOILetter

NCOIL Legislator: States Should Regulate CDS 1
State Negotiates Controversial Medicaid Policy 1
SEC Headlines NCOIL Keynote Address 1
View from the Hill: Congress, Treasury on Move 2
Group Says Hold Fed Dollars Hostage to State Auto Safety Laws 2
Point-Counterpoint: Easing Capital and Surplus Requirements 3

February 2009
www.ncoil.org