National Conference of Insurance Legislators

NCOIL ETTER

...for the states

January 2009 www.ncoil.org

NCOIL TAKES ON CREDIT DEFAULT SWAPS: ACTION EXPECTED AT SPRING MEETING

In front of a packed house in NYC on Saturday, January 24, the NCOIL Steering and Financial Services & Investment Products Committees took first steps toward developing a comprehensive credit default swap (CDS) policy. The Financial Services Committee will discuss the hearing and regulatory strategy when it meets during the upcoming NCOIL Spring Meeting in Washington, DC.

NCOIL President Sen. James Seward (NY) said, "The testimony presented from our expert witnesses…will inform NCOIL policy direction. The message received was loud and clear: that unfettered 'naked' swapping should not be allowed. Participants in the CDS market are not subject to the same strong solvency, reserving, and insurable interest standards that are imposed on actors operating in the insurance market. These standards protected the insurance sector as other financial services industries have struggled or failed during this economic crisis. NCOIL legislators, at the hearing, found the definite need to fill an existing regulatory gap and to provide guidance to the states on how to address CDS regulation."

Financial Services Committee Chair Assem. Joseph Morelle (NY), said, "The Financial Services Committee will be poised to chart a policy course when we meet in Washington, DC, next month. The sheer magnitude of the CDS market—and the fact that estimates on its size and scope vary dramatically—warrant NCOIL consideration of a regulatory framework. Our public hearing laid the foundation for NCOIL action and the Committee must decide the form and strategy of that action. Members may consider advising the federal government on a 'holistic' approach, or creating a state solution that could be based on uniform legislation or, perhaps, an interstate compact."

Participating in the hearing—which ran from 11:00 a.m. to 4:00 p.m.—was NY Ins. Supt. Eric Dinallo; Robert Pickel of Int.'l Swaps and Derivatives Assoc., Inc.; Michael Schozer representing Assured Guaranty and the Assoc. of Financial Guaranty Insurers; Ryan Wilson of AARP; Thomas Hoens of HRF Associates, LLC; Nat Shapo representing the Nat.'l Assoc. of Mutual Insurance Companies; David Ingram representing the American Academy of Actuaries; Michael Greenberger of the Univ. of MD School of Law;

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NCOIL ROUNDTABLES CHART PATHS FOR REFORM

Legislators at the upcoming NCOIL Spring Meeting in Washington, DC, will chart best paths for health insurance and financial regulatory reform during two unique interactive roundtables.

On February 28, a session entitled *Future Healthcare Options: Is Healthcare an Insurable Risk?* will look at an issue of vital policy concern—examining how healthcare is different from other types of insurance, the impacts of healthcare pooling and interstate healthcare coverage, whether there really are new reform ideas, and the prospects for reform under the new Administration.

The roundtable, slated for 1:15 to 2:45 p.m., will feature Jeff Lemieux with America's Health Insurance Plans, Geraldine Smolka with the American Association of Retired Persons, and Cori Uccello with the American Academy of Actuaries. Also invited is Kansas Insurance Commissioner Sandy Praeger on behalf of the NAIC.

A second roundtable, entitled *Financial Regulation: The Past, Present, and Future of State Insurance Oversight*, will delve into causes of today's regulatory impasse and the push-and-pull between states and the federal government, exploring the *Glass-Steagall* and *Gramm-Leach-Bliley Acts*, and the *Commodity Futures Modernization* and *Sarbanes-Oxley* legislation.

Panelists in the March 1 roundtable are Robert Gordon of Property Casualty Insurers Assoc. of America, Robert Hunter of Consumer Federation of America, Gary Hughes of American Council of Life Insurers, and Therese Vaughan of NAIC. The 9:15 to 10:45 a.m. session will be Part One of a three-part series entitled *At the Crossroads of Risk and Reason*.

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

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VIEW FROM THE HILL: SEC, REGULATORY SYSTEM BLASTED

The New Year started off with a bang for the financial services industry. Only days before the Government Accountability Office (GAO) called financial services regulation "fragmented" and "outdated," the U.S. Securities and Exchange Commission (SEC) was taken to task for failing to prevent—or even notice—an allegedly $50 billion Ponzi scheme orchestrated by Bernard Madoff—a scheme the SEC was supposed to prevent.

During a House Financial Services Committee hearing on January 5, after the 110th Congress adjourned but before the 111th was sworn in, Rep. Paul Kanjorski, chair of the Capital Markets Subcommittee said, "Clearly, our regulatory system has failed miserably." The hearing was held to investigate the unprecedented Madoff scam and the need for regulatory reform, and the SEC bore the brunt of lawmaker frustration that the Ponzi scheme had not been uncovered earlier—when red flags first were raised.

A few days after the hearing, the GAO released *A Framework for Crafting and Assessing Proposals to Modernize the Outdated U.S. Financial Regulatory System*. The report detailed the history of financial services regulation, described developments that challenge the existing system, and gave a framework for policymakers developing reform initiatives.

Together, the SEC's most recent failure and the GAO report give additional fodder to a Congress already aimed at regulatory reform. Lawmakers seem poised to pursue an über regulator with systemic authorities as a means to stop repeated federal failures. Unfortunately, insurance regulation—which has managed to swim clear of a riptide of embarrassing headlines—may get swept up in the federal overhaul.

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and Connie Erlanger of Marketcore, Inc.

Regarding options for state action, Supt. Dinallo said legislators could write to Congress arguing that the "Commodity Futures Modernization Act took away a linchpin of state regulation that would have taken away a lot of this activity." While recommending that state legislators give the Administration time to pass a "holistic" approach, he said "state statutes had it right" and that states had "reason to feel scorned."

Mr. Pickel said regulators should have "full information available on regulated and unregulated entities," noting that insurers and regulators should focus on derivative activity. Mr. Wilson said "the individual consumers and investors care little about who regulates these products, but they care a great deal about the stability and safety of global financial markets and any problems that may be caused by a lack of appropriate regulation."

Mr. Ingram said that "we do not see how a future CDS market can be expected to avoid collapse in a credit crisis without some form of effective solvency requirements and risk management oversight." And Mr. Greenberger urged states to take immediate action. He said it is "common sense" that CDS are insurance.

Testimony is available at www.ncoil.org.

CONGRESS EXPANDS SCHIP, SETS TONE FOR BROAD 2009 REFORMS

In a jump-start to 2009 health insurance reform discussions, the U.S. House and Senate overwhelmingly approved a $36 billion expansion of the State Children's Health Insurance Program (SCHIP), which advocates say may cover an additional four million children. Congressional leaders hope swift expansion of SCHIP—a state/federal health insurance program for low-income children who are not eligible for Medicaid—will build the necessary momentum for large-scale health insurance reforms in the coming months.

Among other things, the reauthorization will extend coverage to legal immigrant children and mandate dental and mental health parity coverage for all children in SCHIP plans. Lawmakers will increase the federal cigarette tax from 39 cents to one dollar/pack to fund the expansion. The President has openly supported the measure and should sign it in the coming weeks.

SCHIP has been mired in partisan politics since the original program expired in 2007. President Bush twice vetoed similar expan-

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POINT-COUNTERPOINT: IS USING EDUCATION/OCCUPATION DATA FAIR?

Insurer use of schooling and employment data, though not currently widespread, has sparked debate over whether these factors are fair and what action, if any, state legislators should take. Parties for and against the practice—which is the focus of a special Saturday, February 28, session at the NCOIL Spring Meeting—respond below to the following questions: Should education and/or occupation information be used in insurance underwriting? Why or why not?

The Benefits of Actuarially Justified Underwriting and Rating Factors

By Alex M. Hageli

An insurer's ability to accurately predict losses is a critical component of properly underwriting risks. When insurers are able to properly underwrite risks, consumers benefit with lower rates, more choices and greater market stability.

Insurance risks are commonly grouped by like characteristics for the purpose of establishing rates, and personal characteristics have long been recognized to play a role in predicting likelihood of loss. Age, gender and marital status are all examples of rating factors that have proven to be accurate predictors of loss. Education and occupation are no different, and studies showing a clear delineation of accident frequency among various professions bear this out.

State regulators have repeatedly approved insurers' use of education and occupation. Both Maryland and New Jersey conducted independent studies of the same carrier's use of education and occupation and concluded that such use was objective and served as a valid predictor of loss.

Those insurers that choose to use education and occupation information do so for the same reason they use any other piece of demographic information–because that information is predictive of loss and allows for more accurate underwriting and pricing. Anything less than the use of actuarially justified rating and underwriting factors creates subsidies among consumers and harms the marketplace by stifling competition and innovation.

Competition is about permitting insurers to determine the risks they will accept and permitting consumers to choose the insurance company they want to do business with. Not all companies use the

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Education/Occupation Underwriting Leads to Unfair Discrimination

By Carmen Balber

Schooling and employment have no more to do with whether a driver will crash his car than being blonde or left-handed do. Used by some insurance companies for rating and underwriting, policyholder education and occupation are seemingly neutral factors that, in practice, serve as proxies for income and race. This new, subtler redlining is just as pernicious as the "red line" on the map that insurers and other businesses historically drew around low-income and minority neighborhoods where they refused to do business.

It should be a priority of state lawmakers to protect consumers, including insurance policyholders, from discrimination and redlining. Recent studies of the use of education and occupation, conducted by the FL Office of Insurance Regulation and the nonprofit Consumer Federation of America, reveal that income and racial discrimination are the result.

Supporters of the use of education and occupation argue that they can be statistically correlated with the likelihood of a policyholder filing a claim. However, correlation alone does not justify the use of factors that are unrelated to the risk being insured, especially when they result in higher insurance prices for low-income and minority policyholders.

The reason these practices lead to unfair discrimination is clear when we look at distinctions between occupations made by auto insurer GEICO. According to internal GEICO documents, "favorable" occupations generally "require a bachelor's degree" and include physicians, architects and pilots. Less-desirable occupations include minimally-skilled clerks, long-haul drivers and "lower ranking" military. The unfavorable occupations (that generally provide less income and are more likely to be held by minorities) are assigned to GEICO's more expensive, sub-standard insurance companies.

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The Benefits *(cont. from pg. 3)*

same underwriting and rating tools or to the same degree. PCI supports the right of insurers to decide which tools work best for them and their customers. This benefits consumers by providing more choice and lower rates.

Ms. Hageli is Manager, Personal Lines with the Property Casualty Insurers Association of America (PCI), based in Des Plaines, Illinois.

Learn more about NCOIL at www.ncoil.org

Education/Occupation *(cont. from pg. 3)*

Not long ago, it was acceptable to argue that people of color are a bigger insurance risk. Nevertheless, we outlawed redlining with the Fair Housing Act of 1968. It is equally unjust to refuse or overprice insurance coverage using factors like education and occupation that remain so closely tied to income and race.

Only a ban on use of education and occupation in insurance rating and underwriting will protect policyholders from discrimination – whether unintentional or otherwise.

Ms. Balber is Capitol Director of Consumer Watchdog, based in Santa Monica, CA.

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sion bills and imposed controversial restrictions on states' ability to expand programs. Due to the Bush Administration's stand, Democratic leaders have suggested that this bill's recent speedy passage could be as symbolic as it is substantive.

Senate Republicans, however, have stood firm in their opposition. During lengthy deliberations in late January, they offered amendments to reinstate the five-year waiting period for documented immigrants seeking coverage and "crowd-out" provisions to prevent insured children from dropping private coverage and enrolling in SCHIP. The efforts were unsuccessful.

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