2009 Insurance Economic Summit:
Navigating the New Business Landscape

FOLEY
FOLEY & LARDNER LLP
ADVISEN Productivity & Insight for Insurance Professionals
RAYMOND JAMES
SMART

2009 Insurance Economic Summit:
Navigating the New Business Landscape

Recent and Expected Regulatory Reforms

Chris Longeway, Allstate Insurance Company

Kimberly Shaul, Deputy Commissioner of Insurance, State of Wisconsin

Kevin Fitzgerald, Partner, Foley & Lardner LLP

Randy Wichinski, Managing Director, Insurance Tax Services, SMART

Recent and Expected Regulatory Reforms

3

- Overview of expected federal initiatives that could reshape the insurance industry
- A look at state National Association of Insurance Commissioners (NAIC) initiatives driven by the economic crisis
- Panel discussion: Federal Regulation – Threat or Opportunity?
- Open discussion and questions from our summit and webcast participants

2009 Insurance Economic Summit:
Navigating the New Business Landscape

Federal Charter for Insurance

Regulatory Modernization for the Benefit of Consumers, Agents and Insurers

5

Change is coming ….

- Financial services regulatory reform is a top priority for the 111th Congress and the Obama Administration.
- What will it look like?
- How will it impact insurance?

6

Regulatory Reform Will Include the Insurance Industry

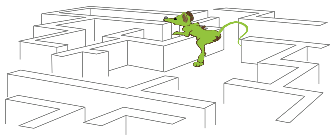
- The Insurance Industry is a Key Player in the Capital Markets:
  - The industry held nearly $5 trillion in government and corporate securities in 2007
  - U.S. total premium for P&C and Life Insurance equaled $1 trillion in 2008
  - There were 2,723 P&C companies and 1,190 L&H companies in the U.S. in 2007
  - The industry is a major U.S. employer, providing some 2.3 million jobs
- The AIG Bailout Illustrates the Need for Insurance Regulatory Reform:
  - The most costly corporate collapse to date was not a bank, but an insurance company
  - The federal government has loaned $180 billion to AIG
  - Large, multi-line insurance companies are critical to our financial system, and to the fundamental security and stability of the national and global economy
- Regulatory Gaps Need to be Closed:
  - No single regulator has a complete picture of the activities of modern insurance conglomerates
  - The state system cannot provide the oversight needed to protect consumers

7

Today's Regulatory Scheme --

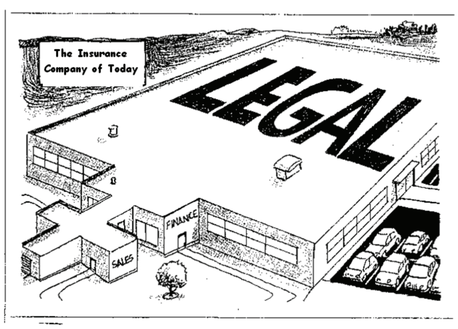
51 Jurisdictions/Regulators

- **50,000 Insurance Laws**
  52 Volumes/ 46,124 Pages of Insurance Laws
- **12,000 Regulations**
  53 Volumes/ 61,533 Pages of Regulations



- **8,700 Related Regulations**
  33 Volumes/ 12,441 Pages of Related Regulations
- **2,300 Insurance Bulletins**
  17 Volumes/ 1,802 Pages of Insurance Bulletins
- **State Case Law**
- **2,000 Circular Letters**
  10 Volumes/ 8,500 Pages of Circular Letters
- **Litigation**

8



9

Shortcomings of State Regulation for National Carriers & Agents

- Lack of Uniformity
- Regulatory Redundancies
- Limited Authority
  - Cannot Address Systemic Risk
  - Regulatory Gaps
  - Cannot Make Agreements with Foreign Authorities on Behalf of U.S.
- Agent Licensing
- Cost of Compliance
- Pricing & Underwriting Controls
- Product/Form Controls
- Lack of Portability for Consumer

10

Why not Focus on State Regulation Reform?

- Regulator Position on Uniform Insurance Regulation:
  - "The Commissioners are now fully prepared to go before their various legislative committees with recommendations for a system of insurance law which shall be the same in all States, not reciprocal but identical, not retaliatory but uniform."

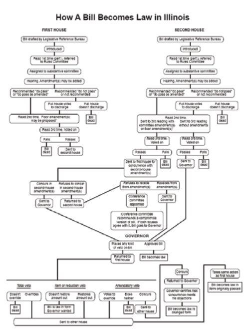
- NY Insurance Commissioner George W. Miller, 1871

11

Why not Focus on State Regulation Reform? (cont.)

Legislative Challenges

50 State Legislatures
50 Governors



12

How Will a Federal Charter Help?

- Insurance consumers benefit from a uniform national regulatory system.
- Regulatory reform will modernize the processes for market conduct oversight and upgrade delivery of valuable consumer services, including the publication of important consumer information.
- Large insurance companies are some of the most complex, multi-national financial services companies in the world.
- Establishing a federal charter for insurance will empower federal regulators to better understand and evaluate potential risks that various insurance industry participants present to the larger economy.
- Creating a Federal Charter brings the insurance marketplace into the 21st century and gives both regulators and insurers the ability to better protect and serve insurance consumers and to compete with other financial services companies.

12

13

Insurance Regulation is not a States' Rights Issue

- Regulating interstate commerce is one of the few enumerated powers of the federal government:
  - U.S. Constitution Article I, Section 8, Clause 3:
  - "The Congress shall have power . . . To regulate commerce with foreign nations, and among the several states, and with the Indian tribes;
- State Regulation was developed at a time when insurance was not considered interstate commerce:
  - In 1869, in Paul v. Virginia, the US Supreme Court upheld Virginia's authority to regulate insurance because the "business of insurance" was local and not interstate commerce and was, therefore, exempt from Federal Regulation.
- Today, U.S. law recognizes that insurance is interstate commerce:
  - In 1944, the US Supreme Court reversed its position and held that insurance was, in fact, interstate commerce. US v. South-Eastern Underwriters Assn.
    - "Any enactment by Congress either of partial or of comprehensive regulations of the insurance business would come to us with the most forceful presumption of constitutional validity. The fiction that insurance is not commerce could not be sustained against such a presumption...."
- State authority to regulate insurance continued only because Congress passed the McCarran-Ferguson Act in 1945

13

09.5558

14

The Majority of the Market Supports Federal Charter

- Life Insurance Companies and their trade, the ACLI, support Federal Charter.
- Despite claims to the contrary, large P&C carriers are generally united in their support for a federal charter – there are only a few dissenters among the top 15 P&C carriers. P&C carriers supporting Federal Charter represent over 50% of the market share.

Top 15 U.S. P&C Companies	Market Share %
State Farm	10.09
AIG	6.46
Zurich	5.69
Allstate	5.43
Liberty Mutual	5.32
Travelers	4.41
Berkshire Hathaway (GEICO) *	3.28
Nationwide	3.20
Progressive *	2.78
Hartford	2.23
Chubb	1.99
USAA	1.93
ACE	1.75
CNA *	1.72
Allianz	1.23
Total	**57.51%**

* Do not support Federal Charter

14

09.5558

15

Trades & Coalitions Supporting Federal Charter

- Financial Services Roundtable (FSR)
  - 90 Companies: 39 Banks, 13 Life Insurers, 9 P&C Insurers
  - FSR is working on the broad issue of financial regulation reform, in addition to focusing on establishing a Federal Charter for insurers.
- Financial Services Forum (FSF)
  - 17 of the largest U.S. financial services institutions (Insurers = Allstate, AIG, MetLife, Prudential)
  - FSF is focusing on the broad issue of financial regulation reform
- U.S. Chamber of Commerce
  - Representing 3 million businesses of all sizes, sectors and regions
  - Focused on the broad Issue of financial regulation reform
- P&C CEO Roundtable
  - Approximately 17 Member Companies
  - Focused on advancing Federal Charter for Insurance and Defeating undesirable dual regulation
- American Council of Life Insurers (ACLI)
  - 340 life insurance companies operating in the United States
  - Focused on advancing Federal Charter on behalf of its membership
- American Insurance Association (AIA)
  - Representing 350 insurers that write all types of property - casualty insurance
  - The only P&C Trade Association advocating for a Federal Charter
- Agents for Change
  - 6,500+ Agent Members
  - Dedicated to advancing Federal Charter on behalf of producers

15

09.5558

Opposition

- State Regulators · NAIC
  - Insurance is a fundamentally different financial product from banking and securities.
  - State officials have been effective stewards of the U.S. insurance marketplace, updating and retooling insurance supervision to meet the needs of the modern economy while preserving and enhancing consumer protections.
  - Federal chartering of insurance companies would dismantle comprehensive state protections, confuse and disrupt insurance markets, undo reforms and harm insurance consumers.
- State Legislators · NCOIL
  - "State officials, Members of Congress, much of the insurance-buying public, and large segments of the insurance industry strongly oppose the OFC concept because it would weaken consumer protections while providing more distant regulation."
  - The strength of state insurance regulation should be recognized as federal policymakers consider reforming financial services oversight. The States · during our more than 135 years of experience · have adapted the insurance regulatory system to respond to market and consumer needs and we will continue to improve and modernize.
- Independent Agents – The Big "I"
  - The Big I opposes federal regulation, optional or mandatory, and supports vigorous, but targeted reform and modernization of the state regulatory system.
  - Local regulation works best for consumers and that the state-based system ensures a level of responsiveness to both consumers AND agents that could not be matched at the federal level.
  - The dual state/federal structure created by an OFC would be confusing to consumers and would require that independent agents become experts in both systems of regulation.

2009 Insurance Economic Summit: Navigating the New Business Landscape

State Regulatory Activities

State-Based Insurance Regulation

- Consumer protection is priority one
- Objective, local accountable oversight with national collaboration
- States are a full partner with Congress and Obama administration
- Provides critical checks and balances
- Long history of consumer protection and market stability

State-Based Insurance Regulation

- State regulators supervise the world's most competitive marketplace
  - 25 individual states among the 50 largest insurance markets.
- State insurance markets are vibrant, competitive and unique
- State insurance officials adept at managing their unique markets.

Interstate Insurance Product Regulation Compact

- Streamlined approval process for product entry into national marketplace.
- Streamlined approach does not come at the cost of consumer protection and solvency regulation.
- Mandated 60 day turnaround process for product filings.
  - Actual turnaround time averages 14 days.
- 35 states and Puerto Rico have joined the Compact.
  - Over one half of entire US premium volume for Life, Annuity, Disability, and Long-Term Care Insurance Lines
  - Legislation pending in CT, NY, NJ

NAIC Uniformity and Speed to Market Modernization Efforts

- Producer Licensing Reform
  - Greater efficiency through technology
  - National Insurance Producer Registry (NIPR)
- H.R. 5611 (NARAB 2)
  - NAIC working to improve non-resident producer licensing uniformity

22

NAIC Uniformity and Speed to Market Modernization Efforts

- Surplus Lines and Reinsurance Reform
  - Nonadmitted and Reinsurance Reform Act
  - NAIC supportive of efforts to improve uniformity in surplus lines multi-state placement.
  - NAIC not supportive of reinsurance provisions
  - Developed alternative reinsurance regulatory framework instead.

23

State-based Solvency Protection

- The ultimate consumer protection.
- Conservative solvency regulation helped insurers weather economic downturn better than other federally regulated financial sectors
- NAIC accreditation program requires states to have statutory solvency requirements.
- No taxpayer dollars involved

24

Systemic Risk vs. Ordinary Risk

- Nature of the insurance industry
  - Systemic risk less likely to originate from insurance companies
- Insurance risks are different than bank risks
  - Less leverage
  - Different types of liabilities
  - Long term focus

25

Systemic Risk vs. Ordinary Risk

- Insurers generally not considered "too big to fail."
  - Even the failure of a major insurer in a marketplace will not cause systemic risk.
  - Other insurers step in to write business for a failed insurer.
  - State guarantee funds protect existing policyholders

26

Systemic Risk vs. Ordinary Risk

- NAIC Principles for Systemic Risk Regulation
  - Primary role for states in insurance regulation
  - Formalization of regulator cooperation and communication
  - Group supervision of holding companies

27

A.I.G. Federal Failure to Regulate

- AIG is a large conglomerate with 176 financial service companies in addition to its 71 US insurance companies
- Core of AIG's problems lie with its Financial Products Company
  - Not a licensed insurance company
  - Located in London
  - Regulated by the Federal Office of Thrift Supervision

A.I.G. Federal Failure to Regulate

- Federal oversight lacked the checks and balances inherent in state regulation
  - Multiple state oversight of AIG insurance companies domiciled in various states.
  - Enables consumer and solvency protection that was not present at the federal level and allowed AIG Financial Products to become a systemic risk
  - As a result, AIG's insurance companies are stable and solvent.
  - Concerned that a systemic regulator could reach down to attach policyholder assets to support a failed financial products company

Federal Proposals

- S. 40 National Insurance Act of 2007
- S. 644 National Financial System Stabilization and Reform Act of 2009
- Treasury proposal: Resolution Authority for Systemically Significant Financial Companies Act of 2009
- National Insurance Modernization Act of 2009 (Bean/Royce bill)

2009 Insurance Economic Summit: Navigating the New Business Landscape

Panel discussion: Federal Regulation – Threat or Opportunity?

Recent and Expected Regulatory Reforms

31

- Overview of expected federal initiatives that could reshape the insurance industry
  - Systemic regulator only
  - Surplus Lines and Reinsurance
  - Monolines
  - Life insurance industry
  - Property and casualty insurance industry
  - Health insurance and managed care industry
  - GAO Report to Congress January 14, 2009, "Financial Regulation: A Framework for Crafting and Assessing Proposals to Modernize the Outdated U.S. Financial Regulatory System"

Recent and Expected Regulatory Reforms

32

- Systemic regulator only
  - No regulation of insurance industry members per se, but some national regulation of entities "too large to fail"
  - Counterparty exposure

Recent and Expected Regulatory Reforms

33

- Federal initiatives that could reshape the surplus lines and reinsurance industry
  - Optional federal charter
  - International issues addressed by single federal regulator
  - Least amount of conflict with states, as states do not heavily regulate these segments of the insurance industry

Recent and Expected Regulatory Reforms

34

- Federal initiatives that could reshape the monoline insurance industry
  - Optional federal charter
  - Like systemic risk regulator, a need for a single regulator to see risks from both sides, i.e. counterparty exposure

Recent and Expected Regulatory Reforms

35

- Federal initiatives that could reshape the life insurance industry
  - Optional federal charter
  - National nature of products
  - "Logical" to have a single national regulator

Recent and Expected Regulatory Reforms

36

- Federal initiatives that could reshape the property and casualty insurance industry
  - Optional federal charter
  - Some P&C lines can vary significantly from state to state (i.e., homeowners' insurance in Florida v. Illinois)
  - But other P&C lines may best be regulated nationally (i.e., credit default swaps)

Recent and Expected Regulatory Reforms

37

- Federal initiatives that could reshape the health insurance and managed care industry
  - Medicare advantage 2010 rate assumptions
  - Obama administration proposed change in policy to support taxing some employee health benefits

Recent and Expected Regulatory Reforms

38

- Federal Regulation – Threat or Opportunity?
  - Optional Federal Charter (OFC)
    - What is it? National Insurance Act of 2007
      - Creates a new federal insurance regulator
      - Federally chartered company would obey state business regulations and federal insurance-specific laws
      - Creates degree of federal & state regulatory competition
      - Federally chartered companies would sell homeowners', life, and auto insurance but not health insurance
      - New national mechanisms for consumer protection
      - Will ensure solvency similar to existing state-level bodies

Recent and Expected Regulatory Reforms

39

- Federal Regulation – Threat or Opportunity?
  - The debate is on! H.R. 3200, S. 40
  - Sandy Praeger, Pres. of the NAIC; Feb 2008 letter to Gov. Marc Racicot, Pres. of American Insurance Association (AIA)
  - American Council of Life Insurers (ACLI) numerous postings regarding OFC on website
  - Tom Wilson, Allstate Chairman and CEO, in a March 11 speech before the U.S. Chamber of Commerce Capital Markets Summit

40

Recent and Expected Regulatory Reforms

- Federal Regulation – Threat or Opportunity?
  – Point (NAIC): For more than 135 years, state-based insurance regulation has proven it can meet the challenges of our vibrant, dynamic industry . . . to protect insurance consumers
  – Counterpoint (ACLI): The insurance industry has evolved into one plagued by inefficiencies and administrative burdens for companies, as well as inconsistent safeguards and product offerings for consumers nationwide

41

Recent and Expected Regulatory Reforms

- Federal Regulation – Threat or Opportunity?
  – Point (NAIC): Lax federal oversight caused current disruption . . . Comptroller allowed unaffordable subprime loans . . . Fed Reserve allowed banks to hold risky derivatives
  – Counterpoint (Tom Wilson, CEO Allstate):U.S. has the most sophisticated capital markets in the world . . . Yet our system for regulating them is a Depression-era hodgepodge

42

Recent and Expected Regulatory Reforms

- Federal Regulation – Threat or Opportunity?
  – Point (NAIC): OFC will create a new federal bureaucracy and allow insurers to “opt out” of comprehensive consumer protection
    - Current proposals would gut consumer protection
  – Counterpoint (ACLI): Life insurance industry consumers deserve consistent and high standards no matter where they live
    - Federally-regulated insurers will respond quickly to consumer needs for new products and standards

43

Recent and Expected Regulatory Reforms

- Federal Regulation – Threat or Opportunity?
  - Point (NAIC): Premium tax dollars are important to the livelihood of every state
    - In 2006, $16.7 billion was collected from insurers
    - How will the new federal bureaucracy be funded?
  - Counterpoint (ACLI): While OFC preserves state premium and retaliatory taxes, state regulation-generated revenues will decline
    - There will likely be a decrease in state insurance regulatory expenses due to fewer state insurers

44

Recent and Expected Regulatory Reforms

- Federal Regulation – Threat or Opportunity?
  - Point (NAIC): It appears that AIA's motivation is to allow complete pricing freedom
    - Pricing freedom may be achieved initially; a crisis or escalating rates will result in more disclosure, similar to two-pronged bank regulatory framework
  - Counterpoint (AIA): Consumers will choose to purchase from state or federal insurer
    - The consumer will have a choice similar to the type of bank they do business with today

45

Recent and Expected Regulatory Reforms

Open Discussion and Questions

Chris Longeway

Kimberly Shaul

Kevin Fitzgerald

Randy Wichinski