FEDERAL ADVISORY COMMITTEE ON INSURANCE

MEETING MINUTES

WEDNESDAY, JUNE 12, 2013

The Committee met in the Cash Room at the U.S. Department of the Treasury, 1500 Pennsylvania Avenue, N.W., Washington, D.C., at 1:30 p.m., with Brian Duperreault, Chairman, presiding.

MEMBERS PRESENT:
BRIAN DUPERREAULT, Chairman
DAVID (BIRNY) BIRNBAUM, Center for Economic Justice
*MICHAEL F. CONSEDINE, Commonwealth of Pennsylvania Department of Insurance
JACQUELINE CUNNINGHAM, Commonwealth of Virginia Bureau of Insurance
JOHN J. DEGNAN, The Chubb Corporation
ANNE MELISSA DOWLING, State of Connecticut Department of Insurance (for Thomas B. Leonardi)
ROBERT EASTON, State of New York (for Benjamin M. Lawsky)
*LORETTA FULLER, Insurance Solutions Associates
*SCOTT HARRINGTON, University of Pennsylvania
SCOTT KIPPER, State of Nevada Department of Insurance
*MONICA J. LINDEEN, State of Montana
CHRISTOPHER C. MANSFIELD, Liberty Mutual Group
SEAN MCGOVERN, Lloyd's North America
DANA SHEPPARD, District of Columbia Department of Insurance (for William White)
MICHAEL E. SPROULE, New York Life Insurance Company

ALSO PRESENT:
MICHAEL T. MCRAITH, Director, Federal Insurance Office, U.S. Department of the Treasury
JAMES P. BROWN, Designated Federal Officer
DAVID MILLER, Associate Administrator, Federal Insurance and Mitigation Administration
ROBERT A. KERZNER, LIMRA

*Participated by teleconference

CHAIRMAN DUPERREAULT called the meeting to order. He welcomed everyone including committee members and attendees. He noted that a few commissioners were unable to attend due to travel restrictions or commitments. He introduced Anne Melissa Dowling from the State of Connecticut sitting in for Tom Leonardi. He noted Rob Easton attending from New York. He indicated that some members were available by phone but initially technical difficulties made it impossible to hear those on the teleconference. The Chairman directed staff to correct the problem. He outlined the agenda to include a discussion of global demographics, reports from subcommittees, an update on Superstorm Sandy from the Rebuilding Task Force and that Commissioner Consedine would do an update on the Reinsurance Captive regulation.

DIRECTOR McRAITH welcomed everyone and noted that Dana Sheppard was here on behalf of Commissioner White. He also acknowledged colleagues who were in attendance, former Alabama Commissioner, NAIC President Walter Bell and former Washington, D.C. Commissioner Larry Morelle. He announced that the Federal Insurance Office had released its first annual report on the insurance industry. A copy has been provided to each of the committee members.

CHAIRMAN DUPERREAULT called for approval of the minutes of the March Meeting. They were approved. He then introduced Robert Kerzner, who is the president and CEO of LIMRA to speak about demographics.

Mr. Kerzner indicated that his discussion would be broader than demographics and would also look at what are the implications and what is actually happening in the life insurance and retirement and savings area. He stated that there is a consistent and ongoing decline in the number of U.S. households that own life insurance. In the '60s, 72 percent of households owned individual life insurance. That has dropped precipitously and is now, as of 2010, at 44 percent with no bottom in sight.

He cited several factors affecting those numbers including:

- Over the next 20 years the growth in Hispanics is expected to be 36 million, while whites will only be ten million, African Americans growing eight, and Asians nine.
- The number of one-parent households has changed dramatically. In 1970 about 13 percent of U.S. households were one-parent. That has grown as of 2000 to 31 percent.
- Fewer Americans are getting married. In fact, there has been about a 41 percent decline compared to 1960.
- U.S. households having children under age 18 have also declined by 21 percent.
- In 1970, only about four percent of women earned more than their husbands. But by 2009, that was up to 29 percent.

Mr. Kerzner then spoke about concerns regarding retirement in the general population and by age group. He cited results from polls and government publications which indicate that different cohorts focus on different aspects of the situation. He indicated that younger people are very concerned about having enough in savings to retire comfortably but are doing little to actually increase their level of saving.

Retirees and pre-retirees are focusing more and more on longevity increases and what that does to assumptions regarding making assets last. Less than half of pre-retirees feel very confident about their retirement. Looking at the demographic of the younger people, 56 percent of them are not contributing regularly to saving plans like 401 Ks. That is important because the odds are that only one in five of Gen X and Gen Y will be covered by a qualified pension plan. The amount of disposable income across age cohorts has declined over the past 30 years. There is a presumption that all the X and Ys' are going to want to buy online or in some different way. And in fact, they want a financial advisor to help them make a decision. About 62 percent of people today who buy life insurance actually go online and do research beforehand. That number was only 30 percent probably four or five years ago. All the data indicates that advisors do make a difference.

The country is becoming increasingly diverse, how people buy, why people buy, what they do and don't do is getting extremely more complicated.

The Chairman thanked Mr. Kerzner for his presentation and asked the committee if there were any questions.

Member Birnbaum asked whether the data showing American households owning life insurance has dropped from 72 to 44 percent can be broken out by product type, ethnicity, and geographic location. Mr. Kerzner indicated it could be by product and ethnicity but not geographic location. Member Birnbaum suggested that such a breakdown would be valuable to the Committee as it studies accessibility and affordability.

Director McRaith stated that it would be tremendously important in hearing not only the issues of retirement security for Americans but how the demographic evolution is in some ways pushing U.S.-based insurers to look internationally for organic growth.

Mr. Kerzner described the demographic situation in many countries citing, *inter alia*, the aging populations of the US, Japan and Europe. The action for the insurance companies will be the emerging markets for two substantive reasons. One is population. Two is they are starting to grow their financial asset base. He also indicated that regulatory measures have a large effect on markets. He cited the growth of 401K's and IRA's decreased the dependence on life insurance. He then contrasted the number of life insurance agents in the US with the number in China. In the United States there are about 169,000 life insurance agents; China Life alone claims to have 800,000 agents; Others boast 400,000.

Chairman Duperreault thanked Mr. Kerzner for his presentation. He then checked and confirmed that Commissioners Lindeen and Consedine and Members Fuller and Harrington were on the call. He then introduced David Miller a member of the staff of the Superstorm Sandy Rebuilding Task Force that was put together by President Obama. Mr. Miller is an associate administrator at the Federal Insurance and Mitigation Agency (FIMA).

Mr. Miller began by refreshing some of the claims numbers from the National Flood Insurance Program (NFIP). As of today, NFIP has paid about $7.5 billion on all paid claims. The breakdown of that in terms of the two main states affected-New Jersey and New York, are as follows: In New Jersey, what NFIP has paid on all claims is $3.6 billion; on all closed claims is $3.4 billion. There have been 66,903 claims closed with payment and 6,428 without payment. That is a closure rate on all claims filed, of about 98.8 percent. The average claim payment in New Jersey is $51, 2039. Paid on all claims in New York is $3.5 billion. On closed claims is $3.2 billion. That represents 53,425 claims closed with payment, 2,929 without. The average claim payment in New York is $60,041 and their closure rate is about 99 percent.

One factor that NFIP is dealing with is the increased cost of compliance issue. This is due to the need for homeowners on the rebuild to elevate their structures. NFIP pays up to $30,000 to elevate.

The current balance in the National Flood Insurance Fund is about $128.4 million. There will be some payments come out of that for current disaster activities. Some payments come out of that for increased cost of compliance but the fund is still generating enough money where there will be no more borrowing, save having another somewhat catastrophic disaster.

Mr. Miller then discussed some of the problems that arose in the aftermath of Sandy. Depending on whether a person has insurance has an effect on how their claim is handled. Without insurance, a claimant could have promptly received a low interest loan or a grant. With insurance, it could take more time to receive a payment due to the usual procedures of verifying an insurance claim. To deal with this, the NFIP created the 5-25-5 program. This provided an advance payment of $5,000.00 to be credited against personal property with payments for structural damage after adjustment. There can also be delays in getting payments into the hands of claimants where lenders are involved and insist that payments are made to them rather than the homeowner. Sometimes lenders will hold those payments until proof of repairs has been submitted. Since insurance proceeds cannot be used for temporary repairs, the final $5,000.00 of the 5-25-5 program is earmarked for things like windows and doors to render a house livable but constitute permanent repairs.

He also cited the problem caused by the policies being actual cash value rather than replacement cost. Insureds' are confronted with the gap that can exist between the two. This was a source of many complaints to state regulators. The NFIP communicated frequently with insurance departments to explain the discrepancy. There were also problems with the 800 number which sometimes was a referral loop which passed the caller on to a different department but didn't resolve the problem. There were also complaints that the number of adjusters was inadequate. Even with the problems, the NFIP between 98 and 99% of claimants have received some payments.

Mr. Miller then turned to the problems created by uncertainty in rebuilding due to remapping of flood zones. Flood maps identify risk by geographic zones. The risk map drives insurance rates. The zone a person is in and the elevation of their property are key elements in pricing insurance. In many areas of New York and New Jersey, that information is very dated, sometimes going back to 1983. Based on experience that data is wrong and if someone rebuilds relative to that data, it is likely to be wrong. And giving what is coming in the Flood Insurance Reform Act, if it is wrong, the penalties could be severe. Not knowing for sure what elevation is necessary to comply with regulations means that the policy payout of $30,000.00 for regulatory compliance may be inadequate. The consequence is that many people are reluctant to rebuild until they know for sure what is going to be required. He then spoke about mitigation programs and the procedures for communities to participate.

Mr. Miller then commented on the impact of the Biggert-Waters legislation on premiums. One of the things it calls for is the removal of the flood insurance subsidies from non-primary residences. This may affect resort communities where some owners might not come back. Others that will be affected immediately under Biggert-Waters are severe repetitive loss and repetitive loss structures, those that have had repeated losses over a certain dollar thresholds. The other impact of Biggert-Waters is caused by mapping changes. Folks who were not in flood zones may now be included. For those newly included the law calls for premiums to start at 20 percent of full rate increasing another 20percent until the full actuarial rate is reached in five years. So mapping changes occurring right now will ultimately have an effect on the build and the rebuild, and the premiums that people pay.

Chairman Duperreault asked if there were any questions.

Member Birnbaum asked if the Program has run through the book of exposures to identify the rate increases by specific exposure and the amount and location. Mr. Miller confirmed that this had been done. Member Birnbaum then asked if it was known how many of those properties are facing rate increases of zero to five percent and five to ten percent, et cetera.

When Mr. Miller said yes, Member Birnbaum indicated that there are a lot of communities that are really up in arms about the NFIP rate hikes. He offered that would be nice to have some information for policymakers on what the actual rate impacts of that are. Mr. Miller said yes but the other part of the answer is because of the way policies are rated, it becomes very individualized.

Director McRaith thanked Mr. Miller for his presentation and asked him to speak briefly on the Sandy Recovery Task Force, what it is, and what its objectives are. Mr. Miller indicated that his involvement with the Task Force was limited to insurance matters and the group's mandate was broader. One of the things that they are looking for is what are the mitigative measures and how can they be applied. In low probability but high consequence events, relocation can be a response. But the FIMA approach of acquiring property and converting it to green zones won't be acceptable in all areas. For example, a category 2 or 3 hurricane, with the same kind of sequencing as in Sandy, would flood Wall Street. He queried " is Wall Street going to move? No. Can it be hardened? What is the cost-benefit? How do you begin to buy-down the risk in those areas? "

Director McRaith thanked Mr. Miller for his time and input.

Chairman Duperreault then asked John Degnan for the report from his subcommittee. Member Degnan then presented the report of the International Regulatory Balance Subcommittee. There was a fairly robust discussion on the five or six questions that the Director propounded.

Mr. Degnan stated that it seems relatively clear that most companies pay careful heed to the implications of the rating agencies' models of business decisions, debt financing decisions, stock buyback decisions, generally the management of capital in deciding whether or not to implement them. Someone made the point that companies don't manage to the model but in their management, they take careful heed of the implications of the model, particularly companies that tend to market their products based on the rating afforded the company. There was a consensus that rating agencies have stepped up their game since 2008 and the models have become much more sophisticated and more transparent.

There was some concern, though, articulated by some members of the subcommittee that the models are not uniformly applied. Some felt that the rating agency models were more stringent for capital management purposes than the RBC model. That was not widely shared by the regulators on the call who had a view that the rating agency models were not sufficiently predictive of solvency and that the RBC model did a better job of that.

Mr. Degnan then invited other members of the subcommittee to make any comments they had.

Chairman Duperreault recognized Member McGovern for comments. He indicated that in lines of business that are rating-sensitive, there is a de facto role rating agencies have assumed in allowing market access into those lines of business. He stated that if you want to get into property catastrophe lines of business, you are required to have a certain level of rating to be able to market your product.

Chairman Duperreault then recognized Member Birnbaum for comments.
Mr. Birnbaum suggested that there ought to be concern if the rating agencies models were more predictive of insolvency than the RBC model. He also voiced concern that operational decisions such as which lines of business to write and rates to charge appear to be similarly influenced by the credit rating agencies. He also questioned whether the conclusion of the subcommittee that

rating agencies did not exert significant influence on competition squared with other findings of the group.

Mr. Degnan responded that all companies make decisions about product lines and rates, based on their own management of their need to get a sufficient return on equity and manage their capital in a way that meets their shareholders' needs or their policyholders' needs at their mutual companies. That is not driven by a rating agency model application as much as it is the competitive nature of the business. He then expressed an interest in a broader viewpoint from the International Association of Insurance Supervisors and a broader regulatory perspective on the degree to which rating agency models should play a part, for example, in supervisory college assessments of a company.

Mr. Degnan acknowledged Mr. Birnbaum’s concern regarding the relative predictive abilities of the RBC and credit models and suggested that a deeper analysis would be of value.

Member Harrington offered his opinion that while the RBC model focuses on solvency, the rating agencies often have higher standards for A plus A plus-plus rating so no one would want the regulators to move toward satisfying the very same requirements.

Mr. Degnan responded that he was not sure that relying on the rating agency models for guidance in the regulatory apparatus necessarily requires some increased capitalization on the part of companies and if so that would reduce competition.

Mr. Harrington stated that it would be counterproductive to making insurance affordable and available if the RBC pumped up the regulatory requirements to get through the hurdles that would be necessary to get an A plus or an A plus-plus rating. Mr. Degnan agreed with the comment.

Chairman Duperreault asked for other comments or questions.

Member McGovern suggested that the intersection between regulation and the rating agencies seems like an area that might be worth some further work. He indicated that another thing of interest is to obtain a better understanding of how rating agency ratings of companies are factored into the regulatory system both in the US and overseas.

Mr. Degnan stated that there had been at least one regulator on the subcommittee who felt that the rating agency models were entitled to no weight in the financial review conducted by the Departments of companies within their jurisdiction. If that is a prevalent viewpoint on the part of the regulators, it might not be of value to advance the idea to international colleagues that such usage is something that is worthy of consideration, given our system in the United States.

The Chairman thanked Mr. Degnan for his report. He then called on Member Birnbaum to give the report of the Affordability and Accessibility Subcommittee.

Mr. Birnbaum indicated that his report would track the memo submitted in response to the Director's questions. The first two questions were: Should we define underserved communities and if so, how? The definitions the group agreed upon were: availability means that essential insurance products are offered by insurers in a particular market and affordability means that the cost of using insurance products is a reasonable percentage of the consumer's income.

In trying to develop a methodology, the first step in the analysis, he suggested, is identifying the insurance product that provides the financial security consumers need. Once that product has been identified, the features of the product necessary to meet the consumers' needs and expectations must be identified. The next step would be to research whether that product is actually available in various markets. If the product is not available in certain markets, the next step would be to research why. If the research shows that insurers are making a product available or would make a product available if consumers could afford the insurance product but that consumers aren't purchasing a product, the next step is to examine the affordability issues.

Mr. Birnbaum continued with the observation that the Dodd-Frank Act identifies three specific characteristics of consumers and markets for FIO to monitor availability and affordability: traditionally underserved communities, minorities, and low and moderate income consumers. The Act identifies two specific and objective characteristics of insurance consumers, race and income. The third characteristic "traditionally underserved" is undefined.
He stated that using this methodology, FIO can identify different product markets and consumer segments, in addition to minority and low income and low and moderate income communities, which are underserved for a particular product.

As to what insurance product should be monitored, Mr. Birnbaum listed the following general categories of insurance that it seems that FIO has the authority to monitor: personal auto insurance, residential and commercial property insurance, life insurance, retirement income, products, hybrid long-term care as opposed to regular long-term care, and credit-related insurance products.

Mr. Birnbaum indicated that the best way to move forward is through a data-driven analysis of the availability and affordability of insurance in specific markets, the idea being that it should be easier to get past earlier debates if there is evidence that everyone is looking at, as opposed to folks staking out historical positions on the issue. He added that FIO is well-positioned to identify global events and trade agreements affecting domestic availability and affordability of insurance products and the ongoing ability of state insurance regulators to impact insurance markets in their states.

The subcommittee suggested that FIO start by working with and building upon existing initiatives and activities. The first step would be identifying existing data collection activities by statistical agents, insurance departments, federal agencies, commercial organizations, which could be shared with FIO and which provide sufficient data to analyze at least some aspects of availability and affordability. And it would also be useful for FIO to identify gaps in the data necessary for monitoring availability and affordability of specific products and markets.

Mr. Birnbaum then thanked Commissioners White and Cunningham and Chris Mansfield for their extensive comments and participation in our discussions and noted that the paper was really a group product.

Chairman Duperreault then recognized Chris Mansfield for comments.

Member Mansfield thanked Mr. Birnbaum for his leadership on this committee. He added that there was a fair bit of discussion about the natural tension between FIO versus the state regulators and there was no desire to disenfranchise either side of that equation.

Member Cunningham also thanked Mr. Birnbaum. She then suggested that the question of prioritization be opened up for discussion by the group.

Mr. Birnbaum offered his opinion that lifetime retirement income products were something that FIO could focus on. He also suggested that the second priority should be property insurance issues. Both of these areas have substantial federal interaction and would seem logical to have FIO involvement.

Director McRaith thanked the members of the committee for their work and thoughtful suggestions. He also stated that there were a couple of process items that need to be discussed informally over the next weeks including deputy participation in committee and subcommittee meetings.

Chairman Duperreault added his thanks to Mr. Birnbaum. He then indicated that the next topic involved reinsurance captives. He stated that Commissioner White, who would normally make a presentation on the matter, was traveling and not in attendance and then called on Member Consedine to give the report by phone.

Commissioner Consedine reported that The National Association of Insurance Commissioners' Captives and Special Purpose Vehicle Subgroup of the Financial Condition (E) Committee prepared a draft white paper addressing the use of captives and similar alternative risk bearing entities by commercial life insurers in the United States. The white paper was exposed on March 15, 2013, and comments were due on April 29, 2013. On June 6, 2013, the Subgroup adopted the white paper, and referred it to the E Committee for consideration. The primary focus of the Subgroup was on U.S. commercial insurers' use of affiliated captives or special purpose vehicles or SPVs. The Subgroup determined that the majority use of captives/SPVs by commercial insurers was related to the financing of XXX and AXXX reserve redundancies. The Subgroup offered recommendations to address the issues presented in the white paper including accounting considerations, access to alternative markets, IAIS standards, and credit for reinsurance model enhancements/added reinsurance disclosure/transparency.

Chairman Duperreault thanked Commissioner Consedine for his report and commented that the NAIC is taking pains to explore the matter. He then asked whether there were any questions for the Commissioner.

Director McRaith thanked the Commissioner for stepping in especially since he has got some things going on in Pennsylvania that prevented him from traveling today.

Chairman Duperreault then recognized Mr. McRaith for a report on international matters.

Director McRaith announced that he would be testifying on international developments the next day before the House Subcommittee on Housing and Insurance. In other matters he reported that at the IAIS the FSB informed the G20 leadership that the designation of global systemically important insurers should be completed in June of this year and at this point, that remains on schedule.

As to ComFrame he indicated that the next version of the written document will be released sometime around the IAIS annual meeting in October in Chinese Taipei.

Regarding the EU/US Insurance Project, it continues and Mr. McRaith said that a lot of good work is being done. In December there will be a public meeting with interested parties, regulators from the EU and the US and industry to talk about experiences with supervisory colleges, including what has happened to date, what are the learning experiences that both the industry and supervisors can share as best practices, and the development of best practices for supervisory colleges.

Mr. McRaith mentioned that the US China Forum would be held in Washington, D.C. in July. He thanked all the committee members and their representatives for their work and input.

Chairman Duperreault opened the floor to questions from the Committee for the Director. Seeing no questions, he announced that the next meeting would be September 18th at a time not yet determined. The Chairman then brought up potential topics for the September meeting and asked the Director whether the Terrorism Risk Insurance Program (TRIP) should be one of the topics.

Director McRaith agreed that TRIP should be on the agenda because of its importance to the insurance industry and to all other aspects of the American economy. The program is set to expire at the end of 2014. FIO is part of the group that will be preparing a report on the program.

That report will be released in the fourth quarter of this year. In advance of that, there will be a federal register notice seeking comment from the public. And that should coincide well with the meeting schedule of September 18th.

Chairman Duperreault invited Committee Members to offer any suggestions they might have for additional topics and then asked the Director for any final comments.

Director McRaith thanked all of the participants in the room and on the phone. In particular, he extended best wishes to Members Fuller and Harrington for full, prompt recoveries.

Chairman Duperreault announced the meeting adjourned at 3:48 PM.