Society of Insurance Financial Management Meeting

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"Insurance Issues Potpourri: Recent Insurance Developments"

Remarks by

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Good Afternoon. For those of you who do not know me, I am Mary Beth Senkewicz and I am the Florida Deputy Insurance Commissioner for Life & Health. Although I am excited to be in sunny (and fortunately "hurricane-free") Miami Beach this afternoon – I must begin by offering an apology on behalf of the Florida Insurance Commissioner Kevin McCarty. Kevin was looking forward to addressing you today, but the Governor asked him to attend the National Governors Association (NGA) meeting in Stowe, Vermont. This is a very important meeting of the NGA, as governors and their representatives from around the country will be discussing federal healthcare implementation, specifically, the establishment of state insurance exchanges by 2014.

My speech today will encompass three important topics that will influence financial executives for the next decade. The first will be the Wall Street Reform and Consumer Protection Act of 2010 or what is more commonly referred to as "federal financial reform." I will then transition into a discussion involving the perennial insurance topic of Florida -- the status of our property insurance marketplace. Finally, I will conclude with the topic dearest to my heart – the Affordable Care Act of 2010, otherwise known as the federal healthcare bill.

Federal Financial Reform

Most of you in this room probably already know the specifics about federal financial reform, also called the Dodd-Frank legislation. However, to recap -- on July 21, 2010 – President Obama signed into law the most sweeping federal regulatory reforms enacted by Congress since the Great Depression. While the federal healthcare debate incited passions and town-hall meeting protests – the public paid very little attention to the substantial changes in our laws involving financial oversight. This is ironic, as I predict that financial reform, not federal

healthcare reform, may have the most enduring impact on our society and the federal/state regulatory framework.

Similar to the federal healthcare overhaul, Congress passed financial reform primarily along party-line votes. The reason the public is not as inflamed as the partisan divide in Washington is very simple: the average citizen simply is not cognizant of the implications of the new law. However, the public <u>does</u> understand there was a systemic problem, and the financial system nearly collapsed during the market meltdown in 2008, which requires a dramatic change to our system of regulation.

In some small way the defining events that occurred during the summer of 2008 may be a blessing in disguise. Federal financial reform was long overdue, and the "Great Recession" that we are now enduring may have given Congress the impetus and motivation to implement needed reforms. Regardless of where you stand politically on this issue, the United States needed to modernize our regulatory framework, as the

system that existed in 2008 strongly resembled the original regulatory framework created in the 1930s.

The new framework must work collaboratively with the global community, implicitly recognizing the global nature of financial markets, and the fact that many of the largest banks and other corporations operate internationally with offices in several countries. The new regulatory framework must also account for a dizzying array of new products and new risks being developed by Wall Street, and in other financial markets around the world. Finally, we must create a more dynamic system – a system that can identify and react more quickly to systemic risks that threaten the stability of the entire financial system.

However, in our zeal to "fix the problem," we must not overreact. While financial reform affects all elements of the financial industry, including the insurance industry, it is important to remember the genesis of the problem: banks and complicated financial instruments, specifically, collateralized debt obligations, and sub-prime mortgage debt instruments. To illustrate this point, we can analyze the recipients

of the federal government's TARP (Troubled Asset Relief Program). Nearly 600 banks required billions of dollars of government assistance with their troubled assets; in contrast, only three insurance companies utilized TARP funds.

The National Association of Insurance Commissioners (NAIC) has worked closely with federal policymakers to help them learn the lessons of why banks experienced a financial crisis, while insurance companies (some of which were owned by these very same banks), seemed to survive the financial crisis relatively unscathed. One of the primary reasons is the more conservative investment approach codified into statutory accounting principles. Insurance regulators would not have permitted many of these risky investments. In addition, the insurance industry has historically offered more transparency and consumer protections, as well as directly benefitting from the state-based insurance regulatory structure. Fortunately, federal policymakers heeded much of the advice, and the NAIC played an important behind-the-scenes role in

helping to shape this legislation, especially from an insurance perspective.

One of the key components of the federal legislation is the creation of the Financial Stability Oversight Council (FSOC). This council has 10 voting, and 5 non-voting members charged with the responsibility of identifying companies that are "too big to fail." One of the non-voting members is an insurance regulator, and we recently learned that John Huff, the Director of Insurance for the Missouri Department of Insurance has been appointed to this position. This council has three distinct roles: 1) to identify systemic risks to the U.S. financial system which includes analysis of both financial and non-financial institutions; 2) to promote market discipline; and 3) to respond to emerging threats to the U.S. financial system.

One of the more interesting elements of the Dodd-Frank legislation is the creation of a Federal Insurance Office (FIO). On the surface, this appears to present some thorny issues given the federal government-state government relationship in overseeing insurance regulation. Initially the

concept of a Federal Insurance Office included the potential for insurance companies to obtain an optional federal charter – however – this did not come to fruition. The FIO will be responsible for working with the Treasury Department to negotiate “covered agreements” with foreign countries on the issues of insurance, and along with the Federal Reserve Board, will help determine if an insurance company is systemically risky and in need of resolution if state regulators fail to take appropriate action.

As for the impact of the Dodd-Frank bill – this remains to be seen. Certainly, the 2010 election cycle may have an impact on the implementation of this legislation. In addition, while the bill established the Financial Stability Oversight Council and the Federal Insurance Office, many of the regulatory rules still need to be promulgated. We will also need to observe how these entities confront actual financial problems in the marketplace to determine how they will truly function.

Property Insurance in Florida

At this point in my presentation, I will begin an awkward pivot to another topic – the property insurance market in Florida. This certainly does not have the national implications of federal financial reform or federal healthcare reform – but the health of Florida's property market continues to be critical to Florida's economic environment.

In many respects, the underlying economic circumstances have not changed. We have not had any major storms in Florida this hurricane season. As importantly, despite Hurricane Earl's brush with the North Carolina coastline, and Tropical Storm Hermine's rain in Texas – the Gulf States have been relatively unaffected by the storm season to date. One may ask how catastrophic events in North Carolina and Texas can affect Florida; the answer is simple. Insurance companies in all states rely on reinsurance for catastrophic events. This limited pool of global reinsurance is not directly related to risk, but instead, relies on the vagaries of the supplies and demand of the marketplace. Therefore, a quiet storm season for other coastal states is also good news for Floridians.

While the lack of storms in the Gulf Region this year has been a positive development, the underlying cost drivers have remained the same. During the 2010 Legislative Session, Commissioner McCarty identified five of these cost drivers affecting Florida's property insurers. These include: 1) increased reinsurance costs; 2) replacement cost methodology; 3) fraud; 4) reported sinkhole claims; and 5) premium reductions from the full implementation of mitigation discount credits.

One of the cost drivers that has become even more prominent recently is the issue of sinkhole claims. There has been anecdotal evidence of an increase in sinkhole claims, especially in regions outside the traditional "sinkhole alley" in Hernando and Pasco Counties. There also have been some allegations that unscrupulous individuals may be "gaming the system" by encouraging policyholders to file questionable claims in the hopes of obtaining a settlement despite the lack of sinkhole evidence. To take this issue out of the realm of anecdotal stories into the realm of statistical measurement – the Office has instituted a data call to all residential property insurers in Florida. The Office hopes to release a

report on this issue in late October or November. Depending on the findings, this data could potentially be used to shape legislation that changes the current incentives in the system to address this cost driver.

As for the financial status of Florida's property insurers – the Office is still in the process of reviewing the second quarter financial data that was due August 15. Generally, the results are consistent with last year – the downturn in the economy combined with the cost drivers in the system continue to put pressure on the marketplace. Consequently, the Office has been involved in several hearings for rate increases. Recently, both Castle Key Insurance Companies (formerly AllState) and Royal Palm Insurance Company have received rate increases. These increases are partially due to the fact these companies have not made full rate filings since 2007 or 2008, and partially due to the statistical evidence of cost-drivers in the system. The Office is committed to working with policymakers in Tallahassee to address these cost drivers in the future.

Federal Healthcare Reform

I will now transition to my favorite topic --- federal healthcare reform. As you know, in March 2010, Congress passed two separate pieces of legislation, commonly referred to as the Affordable Care Act (ACA) that promised to expand health insurance coverage to millions of Americans. Although the bill was characterized as "federal reform," the states will be primarily responsible for implementation. Therefore, overhauling state health insurance laws will be one of the primary legislative objectives of the Office during the 2011 Legislative Session.

One may ask why the Office, a non-partisan government agency, is making the overhaul of the Florida insurance code on healthcare issues a legislative priority. Certainly health care reform is a very politically contentious issue; some legislators around the country have even openly advocated for a repeal of federal healthcare. However, the ACA is currently the "law of the land" and it is our responsibility to present to Florida's policymakers the logistical needs and considerations required to implement the current federal law.

To understand the scope of our effort, it is important to review the chronological timeline for health insurance market changes under the federal law. One of the immediate impacts of the ACA was the creation of the Pre-Existing Condition Insurance Plan (or "High Risk Pool") by July 1, 2010. This health coverage is intended for people that have pre-existing health conditions, and who cannot find traditional health insurance coverage because these conditions make them "uninsurable."

Our state, under the leadership of Gov. Crist, did not believe the money allocated by the federal government would be sufficient to run this plan effectively at the state level. Therefore, Florida was one of 23 states that "opted out" of this plan, which means our state, will be deferring to the federal government to run this pool. However, this does not mean Floridians cannot utilize this coverage. In fact, the federal government began accepting applications from Floridians beginning July 1, 2010. To my knowledge, HHS has not released data as to how many Floridians have availed themselves of this new coverage.

Another important date for federal health care implementation was September 23, 2010. Some of the key reforms that were automatically implemented include: 1) no lifetime limits on health insurance benefits, 2) restricted annual limits on essential health benefits, 3) first-dollar coverage for certain preventative services, 4) strict limitations on rescissions, 5) dependent coverage up to age 26 (current Florida law allows dependent coverage up to age 25, with optional coverage up to age 30), and 6) the elimination of pre-existing conditions for children. Technically these benefits under the ACA are automatic upon renewal of a plan, but in practical terms, the Office has expended resources to review form filings for small group, individual, large group, and out-of-state group carriers that comply with the law.

Major Changes for 2011

There are also major changes slated to begin in 2011. Perhaps one of the most contentious issues of health care implementation is the standards in the law for Medical Loss Ratio (MLR). Federal legislators wanted to ensure that a specific portion of the premium dollar is

designated for direct medical benefits and quality of care improvement for consumers. The federal legislation establishes different ratios for large group (85%) than for small group and individual health coverage (80%). Although well-intentioned, this static formula does not take into account the importance of health insurance agents, who will need to be increasingly relied upon to help consumers navigate the growing complexity of health insurance.

After conducting a public hearing in Orlando in May and soliciting testimony from agents, insurers, and consumer advocates – the commissioner has written letters to both HHS Secretary Kathleen Sebelius, and NAIC President Jane Cline expressing our concerns, and advocating a delay in the implementation of these standards. In addition, at the national meeting of insurance commissioners in Seattle, Washington, the Florida delegation helped build a coalition to pass a resolution expressing the NAIC's commitment to retaining the role of health insurance agents in the process of selecting health insurance. At the state level, the Office intends to work with state policymakers to pass

legislation that sanctifies the importance of health insurance agents into the law by exploring different methods of defining agent commissions that comply with the federal law, and the definition of MLR.

However, our major legislative effort in 2011 will be conforming legislation for the immediate changes, and to expand the Office's authority to regulate rates for the large-group health and out-of-state group markets. Currently the rates charged by these health insurers are not regulated in Florida. Above and beyond the creation of new laws, the Office may need additional resources including form analysts and actuaries to implement these laws. The largest overhaul of the health insurance system will be in 2014 with guaranteed issue and the elimination of pre-existing conditions, as well as the establishment of the health-care exchanges for the individual and small group markets. The exchange would be a virtual marketplace to help insurers compete on a cost efficiency basis while complying with consumer protections. The goal of the exchange is to facilitate the purchase of health coverage by supplying an effective marketplace.

Florida was one of 45 states that received a $1 million grant from the Health and Human Services (HHS) to enhance the rate review process. Not only will Florida need to change its current laws, but also the Office of Insurance Regulation will need to use this grant money to add personnel, draft legislative changes and expand IT resources to comply with the federal reporting guidelines.

However, the largest overhaul of the health insurance system will be the establishment of the health-care exchanges in 2014 for the individual and group markets. The Commissioners is with the Governor this weekend as the Governors from other states meet to discuss this very question: how to establish a state-exchange. The exchange is intended to be a virtual marketplace to help insurers compete on a cost efficiency basis while complying with consumer protections. The goal of the exchange is to facilitate the purchase of health coverage by supplying an effective marketplace.

In conclusion, when President Obama signed the final piece of the Affordable Care Act in March 2010, this may have marked the end of

the federal legislative process, but it only marked the beginning of the implementation process. Under the federal law, states were given the primary responsibility of adopting new laws, finding new resources, and expanding healthcare to 30 million Americans.

The Florida Office of Insurance Regulation will act in the public interest by attempting to implement the current law of the land, informing insurance companies of important deadlines, and assisting Florida's policymakers of the requirements of the federal healthcare to allow them to make decisions as how to best implement these changes.

This concludes my remarks this afternoon. I thank you for your time and attention to these important issues, and I would be glad to respond to any of your questions.