[INSIGHT] By Peter H. Bickford

Let The Free Zone Ring!

The insurance and financial industries are constantly seeking new risk spreading options. In recent years these new options have included, among other things, cat bonds, sidecars, special purpose vehicles and insurance linked securities. Alternative risk facilities and options exploded on the scene in the 1980s as a result of tremendous swings in capacity and availability. For instance:

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- The first Vermont captive insurance company was licensed in 1981.
- The first liability excess facilities were established in Bermuda in 1986.
- The Liability Risk Retention Act that allowed for the creation of risk retention groups and risk purchasing groups was enacted in 1986.

The revolution actually began, however, in 1978 with the enactment in New York of Article 62 (the New York Insurance Exchange) and Article 63 (Special Risks) of the Insurance Law. While the exchange experiment – seeking to create a Lloyd's type facility in the US – was short-lived (more on this topic in the future), the Special Risk article, commonly referred to as the Free Zone, lives on.

The Free Zone law allows New York licensed insurers to obtain a special Free Zone license to write large commercial or hard-to-place risks free from rate and form filing requirements. The standards and requirements for defining large commercial risks, and the list of hard to place risks that can be written in the Free Zone are set out in Regulation 86, which has been amended and expanded over the years to address changing conditions and needs. The current administration is continuing this effort through the promulgation of a new amendment to the Free Zone regulation, Regulation 86.

To the credit of the Department of Financial Services, the Fourth Amendment to Regulation 86, published in the State Register on June 20th, makes significant improvements to the existing regulation by lowering the threshold for large commercial risks, improving the premium to surplus ratios for Free Zone licensees, and expanding and updating the list of hard-to-place risks that can be written through the Free Zone. The regulatory impact statement accompanying the proposed regulation does a good job summarizing the background of the Free Zone and the purpose of the changes to the regulation. Most significantly, the regulatory impact statement discusses the extent and nature of suggestions received by the DFS from industry groups on changing Regulation 86, with an explanation of why it accepted some changes, rejected others or took a different approach to address a particular issues raised. While not everyone may be happy with the final regulation, this kind of explanation and analysis is helpful to and welcomed by the parties that utilize the Free Zone in their business, and to know that their concerns and comments are being considered in a meaningful manner. It is hoped that this open approach will be the standard for the DFS and not an exception.

I would also urge that the DFS consider an additional level of disclosure. In the 2010 Report of the Superintendent of Insurance to the Legislature, it was reported that there were 222 companies with Free Zone licenses as of year-end 2009 that wrote approximately $1.54 billion in net premiums written during the year, bringing the net premiums written in the Free Zone since inception to approximately $15.18 billion. This report is far too limited and perfunctory to be of any meaningful value to industry or potential industry participants. But even this limited information was more than provided in the stripped down 2011 annual report of the new DFS, which includes no information on or discussion of business written through the Free Zone, or any other specific line or type of business. It would be very helpful to the industry, its customers and investors to have far more detail — both current and historical — about such aspects of the Free Zone as volume, usage, category of risk, efficiency and cost effectiveness. This is the kind of information

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that successful managers use to consider their business or investment strategies. The more extensive the availability of reliable information, the more confident managers can be in their business or investment decisions.

The value of such disclosure is not just to the business and investment decision makers. Such information should also be of interest to regulators and legislators in assessing the effectiveness of particular legislation and regulations, leading to appropriate improvements or adjustments to both.

Case in point: in November 2011 the DFS issued the third amendment to Regulation 86 to implement a change to the Free Zone statute to add a new category of permissible placements – to large commercial insureds as defined in the Non-Admitted and Reinsurance Reform Act (NRRA), a part of the 2010 Federal Dodd-Frank legislation. The amended Free Zone legislation and enabling regulation were criticized for the restrictive, redundant and unnecessary filing requirements that undermine and detract from the intent and purpose of the large commercial insured concept in the NRRA (See, for instance, my article, ***Strike One!*** appearing in the December 19, 2011 issue of ***Insurance Advocate***). Keeping track of and reporting on the usage of this new category would assist the DFS and the legislature in determining the effectiveness or ineffectiveness of the law and regulations that could lead to improvement in both, including the possibility of proving the criticism to be wrong.

There are a number of statutory or regulatory requirements for companies, agencies and others to compile and report data to the department. It is a waste of everyone's resources if that data is not cumulated, analyzed and the results appropriately and openly shared with all interested parties including industry participants, investors, service providers, consumers and legislators.[IA]