

A Desert Flower

The “Looking Back” feature in the past couple of issues of IA have been cruel reminders of the abrupt and inglorious closing of the old New York Insurance Exchange twenty-five years ago. These reminders have led to a new flurry of inquiries: What ever happened to the

of the statute and asking serious questions about how a modern, technologically advanced exchange could be a useful additional capital resource to the industry. Unfortunately, the 2008 financial crisis manifested itself disrupting his continued pursuit of the idea.

with regulators, legislators, rating agencies, potential investors, underwriters, managers, brokers, intermediaries, financial institutions, and service providers nationwide resulted in the conclusion that, although not universally supported, a positive climate existed for establishing an efficient, technically advanced syndicated exchange market in the US. Based on this input, a plan to implement the working group recommendations was drafted (A copy of the draft plan is posted on my website at www.pbnylaw.com/ny-insurance-risk-exchange/).

Unfortunately, the draft plan was never fully approved by the NY regulators before the administration changed again. This time, however, the change in administration was accompanied by a complete overhaul of the statutory framework for regulation of the industry through the merger of the banking and insurance departments into a singular department of financial services. This merger pushed the exchange project off the radar screen. While it is not currently under consideration by the current administration, it should be emphasized that the exchange concept has not been rejected by the administration either. Although the merger and other issues such as Sandy have taken attention away from the exchange, this is clearly a time for regulators to consider all kinds of innovative approaches for drawing private capital to the risk-spreading needs facing society today and in the future. Private companies, no matter how big, cannot address our growing need for adequate capital to address the mega-risks we are facing, including the transformation of risk from “tangible” risks such as life, home, auto and business risks, to intangible risks such as reputation risk, cyber risk, modern technology, and intellectual property, and supply-line risk.

The value of a syndicated exchange as a source of capital for the industry to have the capacity to address the changing world of risk is a proven concept – Lloyd’s has been doing it for over three centuries. The major impediments to following suit in the



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effort to revive the exchange? Has the effort been abandoned at last? Is it finally dead? The problem with these reminders is not so much the closing of the original exchange, but the lingering belief that its “failure” should preclude any effort to reconsider establishing an insurance risk exchange facility today or at any time in the future.

These reminders also fail to consider the inevitability of the growing need for structured, secure and flexible capital facilities to address the mega-risks society increasingly faces, such as catastrophic weather events, global supply risks, cyber attacks, and future generations of “asbestos” risks we do not even know about yet. What all these risks have in common, however, is the ever-increasing amount of capital needed to ensure society’s ability to protect itself. Something that a syndicated market such as an insurance risk exchange, can address in a structured, controlled market environment far better than many other options.

Two past NY regulators understood the need to explore new ways to spread risk and attract capital to that effort. In 2007, then superintendent of insurance Eric Dinallo asked a simple question: why aren’t we using the existing statute authorizing an insurance exchange? He began exploring the history

In 2010, however, Dinallo’s successor, James Wrynn, took the idea even further by establishing a working group of industry and regulatory leaders to explore the need and viability of establishing a new insurance risk exchange. After a year of extensive work by a number of sub-groups, the working group, to which I was privileged to be an advisor, concluded that a new, modern, efficient exchange was not only feasible but could add considerable value to the industry. However, it also concluded that for a new insurance risk exchange to be successful, it must:

1. Provide a strong and secure capital base to support regulatory and rating agency acceptance;
2. Provide for prudent and flexible oversight;
3. Provide an efficient, cost-effective and technologically advanced platform for the facility and its members.
4. Achieve 50 State access for syndicates on both a reinsurance and surplus lines basis; and
5. Provide as expansive a market as possible through legislative and regulatory support.

Following these conclusions, the NY regulators together with interested industry leaders conducted informal discussions

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DFS Licensees Keep Getting in Trouble

According to the Department of Financial Services' January 2, 2013 release of disciplinary actions, 7 DFS licensees were revoked while 41 others were imposed fines ranging from \$500 to \$63,000. All since the DFS' previous release of disciplinary actions in September 2012.

As expected, a handful of small fines (\$500, \$750) were for technical reporting violations, such as failing to report to the DFS within 30 days of the final disposition of another insurance department matter or failing to disclose a prior criminal conviction on a DFS application. Presumably those licensees fully cooperated with the DFS' investiga-

tions and had no prior disciplinary actions.

Other fines involved continuing to act as a licensee after a license had expired, or transacting business under an unapproved name, or unlawfully paying commissions to unlicensed employees. Only one fine was issued in connection with an advertisement and that involved specifying an insurance rate without providing the full name of the insurer referred to and the city of the insurer's principal place of business.

More substantial fines (up to \$15,000 to one respondent) were issued in connection with failing to properly file excess line broker affidavits and others (\$2,000, \$9,100, and \$63,000 respectively) involved the solicitation, negotiation and or delivery in New York of annuity contracts issued by an unauthorized insurer. The disparity of the fines suggests they may have been calculated based upon a percentage of the

premiums written and/or the number of statutory violations.

The penalty of revocation was imposed to brokers who collected insurance premium payments from insureds but failed to remit the payments to the insurers or who failed to replace an insureds' funds after premium checks were dishonored by the bank. One agent was revoked for misappropriating money and falsifying bank records in order to conceal the misappropriation (which also resulted in misdemeanor convictions).

The most shocking conduct resulting in revocation involved the submission to the DFS on a renewal application for an agent's license that named an individual who had previously died as "President and sublicensee." Now this is one sure way of getting in trouble that I had not seen before! [A]

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US are our fragmented national regulatory scheme, our natural fear of change and, frankly, the belief that the failure of the original exchange "proves" it cannot work here.

The kind of insurance risk exchange conceived by the working group and exchange proponents, however, is not the exchange that "failed" in the 1980s. If anything, the original was well ahead of its time, and existed at the onset of the explosion of alternative risk vehicles — including captive insurance companies, liability excess insurance facilities, risk retention groups, special purpose vehicles and insurance linked securities — and at the onset of the technology revolution.

Furthermore, a modern, efficient, technologically advanced insurance risk exchange fits squarely within the current administration's PR theme, widely publicized through TV and print ads: "New York is no place for business to dream small!" I could not agree more, and the idea of a new insurance risk exchange fits

perfectly under that theme.

In the end, you can scoff at the idea of re-considering an exchange, but it is not going to go away because it should not go away! Like a flower in the desert, all it needs is a little rain to bloom brightly. Eventually the rain comes — even in the desert!

REPORT CARD UPDATE

In my last column I provided statistics from the DFS Report Card on insurer performance relating to Sandy claims. The

data was from the DFS website as of December 20, 2012 (www.NYinsure.ny.gov). Subsequently, the DFS updated the statistics through January 14, 2013. Following is a comparison showing the changes from December 20, 2012 to January 14, 2013. As can be seen, the overall picture is changed minimally, and could lead one to conclude that this is a pretty good final snapshot of the Sandy picture. What we need now is for the DFS to let us in on its assessment of this performance — if it has one.

	12/20/12	1/14/13
Total number of claims	372,785	381,827
Total number of complaints	1492	1,830
Complaints as a % of claims	0.40%	0.48%
Claims closed with Payment	187,235	227,344
Claims closed with Payment as a % of total	50.2%	59.5%
Claims closed without payment	56,887	63,767
Claims closed without Payment as a % of total	15.3%	16.7%
Average time in days, claims report to payment	19	19
Total number of adjusters Working on Sandy losses	5,417	4,795