

Motivational Misdirection

Anyone who loves a good mystery knows that determining motivation is a key element to understanding actions. But as in all good mysteries, motivation can be cleverly concealed or woven into the fabric of a tale. We are probably

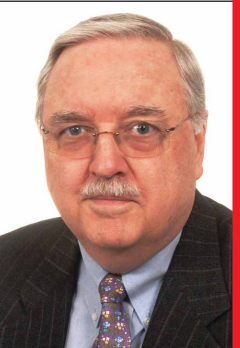
sophisticated states, thus undermining the whole fabric of state regulation of insurance. To his apparent chagrin, however, the NAIC continued on its plodding course toward principles-based reserving, or PBR. This led to a scathing rebuke by

of matching risk and reserves and a better way of adapting to new products and changing marketplaces? Strict disciplinarians need clear, unambiguous rules to control their domain. The last things they want or can tolerate are wishy-washy, bendable rules making it harder to control the miscreants under their jurisdiction.

The second example is a developing dispute about what constitutes the conduct of business without a license. In March the Department of Financial Services announced a \$50 million fine against Met Life and a couple of non-New York life insurance affiliates that had been acquired from AIG for illegally soliciting insurance business in New York without a license. Although the violations cited were ongoing from before the acquisition from AIG, and although AIG is prominently referenced in the consent agreement, AIG was not a party to the agreement. Met Life and its affiliates, on the other hand, not only acknowledged the violations and accepted the substantial fine, they also agreed to cooperate with the DFS in its ongoing investigation and enforcement actions against AIG. The settlement with them appeared to be akin to a plea deal with one perpetrator that agrees to cooperate with the authorities in pursuing another perp.

But then something interesting happened. AIG sued the DFS to stop it from going after AIG under the terms of the consent agreement with Met Life, arguing that the consent agreement exceeds the regulator's authority and deprives AIG of its due process rights. At first blush this might seem as a simple ploy to avoid the long-arm of the law, but a full reading of the complaint raises some very interesting factual issues regarding the activities the DFS claims constitute the unlicensed business of insurance in New York.

The most interesting allegation raised by AIG is that the alleged illegal activity does not involve New York insureds and therefore should be of no concern to the New York regulators whose purpose is to protect New York residents. AIG admits in its complaint that it conducted market-



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all guilty at one time or another of the practice of misdirection in order to achieve a goal, whether it is as simple as bluffing at cards, pulling off a hidden ball trick in baseball or touting our own product's benefits over an competitor's equally effective product. It is also likely too much to ask that our regulators be above the fray and act with total impartiality and fairness. Unfortunately, regulators are human as well, and can be as effective at misdirection as the best of us. Two recent disparate developments illustrate the point: New York's opposition to the development of principles-based reserving and its recent settlement with Met Life over the issue of doing business in New York without a license.

Since shortly after becoming superintendent of New York's new department of financial services (DFS) Ben Lawskey has been critical of the NAIC's effort to move toward a principle-based reserving protocol to replace the existing formula-based approach. His position, ably presented in a detailed letter to his fellow commissioners in November 2012, strongly suggested that the effort would weaken the financial condition of insurers by allowing them to reduce reserves through their own modeling, and would overwhelm the capability of insurance regulators to monitor these models, particularly in the smaller, less

Superintendent Lawskey in a letter to the commissioners last September that scolded his fellow commissioners for not "quelling the gamesmanship and abuses" by the industry in its reserving practices, and that PBR would represent a "potent cocktail that could put policyholders and taxpayers at significant risk." He also referred to the restraints in PBR as "so loose as to be illusory" and finally accused his brethren of learning "the wrong lessons—or no lessons at all – from the recent financial crisis." It seems to really bug chief Lawskey that the NAIC has continued in its usual plodding manner to consider PBR even in view of his well-reasoned, irrefutable criticisms. Is it possible that this reaction – or over-reaction to many – is a sign of some other motive for his position? Is the volume of this attack yet another in a long line of markers demonstrating that the current concept of insurance regulation in New York is primarily, if not exclusively, enforcement-centric? Think about it! If state regulation of insurance becomes more principle-based over formula-based, enforcement-centric state regulators such as New York will find it more difficult to apply absolute rules against the crooked, scheming insurance industry. Is this the underlying motive behind the attacks on the NAIC's efforts to find a truer method

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ing and other services for its non-New York affiliate using expertise housed in New York, but that there is nothing improper or illegal about such activities because the affiliate was not covering New York residents. AIG argues that New York exceeded its authority by attempting to regulate a non-New York company that is not insuring New York risks, but also that its actions

have created an absurd catch-22 situation: the company is required to be licensed in New York even if it is not insuring New York residents, but cannot obtain a license in New York for the same reason.

After reading the complaint, I went back and re-read the consent agreement. Sure enough, as alleged in AIG's complaint, there is no reference to any solicitation or underwriting of coverage for New York residents. Additionally, the consent agreement includes no requirement that the Met

Life affiliate acquired from AIG obtain a New York license or divest itself of any improperly solicited business. Why not?

The DFS has refused to respond to the AIG complaint (the old "we do not comment on pending litigation" mantra) although clarification would be helpful to understand the basis for its enforcement action. It would be very helpful to know, for instance, why New York regulators object to a non-licensee using personnel and expertise located here in New York so long as it was not interfering with the rules for insuring New York residents. What is the benefit to the State by chasing these jobs out of state? Is this another example of the short term, enforcement-centric mind set of the current New York regulators being blind to and interfering with the economic interests of the industry and the State?

The AIG lawsuit may or may not help answer these questions, but without it the questions may never have even been asked and the motives never questioned. [A]

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technology, big data analytics, legal and other fields," said **Alex Krutov**, chairperson of the Task Force on Cyber Risk. "We encourage other professionals and organizations to join us in the important effort of advancing research and education in the area of rapidly evolving cyber risk." Many aspects of cyber risk remain poorly understood. With few exceptions, the expertise needed to analyze cyber-related events such as data breaches or business interruption, their probabilities, and their ultimate financial impact is limited, both at the companies directly exposed to the risk and in the insurance industry. Often, unscientific qualitative methods are used for this task. While there is a growing body of research on some of the specific IT aspects of the risk, it is particularly difficult to tie that research to financial outcomes and insurance coverage. The Task Force on Cyber Risk intends to contribute to this ongoing research, but its primary research goal is to utilize a multidisciplinary approach in order to gain a more comprehensive and accurate view of cyber risk. The need for such improved understanding of cyber risk cannot be overstated. [A]