 By Peter H. Bickford

News Flash: Tail Wags Dog!

The insurance media sometimes does not know quite how to report on pronouncements by our fearless regulatory leader in New York. This is probably because so many of his statements are about "financial services" without distinction between industries, and insurance industry reporters are not always sure if he is including, excluding or consciously ignoring insurance. That uncertainty may explain why the insurance media's reporting on the recent speech by New York's superintendent of financial services, Benjamin Lawsky, seems to pass over the main substance of the speech.


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Speaking at the hallowed venue of Columbia Law School, Superintendent Lawsky talked about a number of financially related topics, aimed particularly at Wall Street and the banking industry. He urged that regulators do more to hold individuals as well as corporations accountable for Wall Street's misdeeds, and proposed enhanced monitoring and filtering systems to prevent widespread money laundering benefiting criminal activity and terrorism. His last topic was cyber security in the financial area, which he called "the most important issue we will face in 2015 – and perhaps for many years to come after that." Following so closely after the February report by the DFS on cyber security in the insurance sector, it is understandable that the insurance media focused on this part of Lawsky's speech. Cyber security is a major issue as Superintendent Lawsky correctly points out, although his emphasis is almost exclusively on the security of data held by insurers rather than on the creation and support for development of cyber security insurance products.

But cyber security was not the major point of the speech. Titled "*Financial Federalism: The Catalytic Role of State Regulators in a Post-Financial Crisis World*," Superintendent Lawsky revisited one of his long-standing themes and justifications for his regulatory approach. Lawsky first introduced us to his concept of "financial federalism" back in May 2013 in a speech before a conference on the U.S. and world economies. In that speech, accessible on the DFS website, he outlined his view of the relationship between state and federal regulators ranging from "cooperative federalism" where state regulators work closely together with federal regulators on an issue; to "persuasive federalism" where states have to lead federal regulators by example; and finally to "coercive federalism" where states must act alone because of federal inaction. In his latest speech, Superintendent Lawsky revisits his federalism theme, emphasizing cooperation but not backing down from confrontation where necessary. For instance he states that: "We should strive, of course, for a collaborative and cooperative relationship with our federal partners. That is certainly our goal at DFS. But states also should not be afraid to speak up and act if we spot new risks emerging in the market."

Superintendent Lawsky's brand of federalism, however, is aimed almost exclusively at Wall Street – bankers and capital providers – rather than the insurance industry. When the insurance industry is included, it is more often than not as an end-user, such as with the current cyber security issue; or as an adjunct to a banking issue, such as the old force-placed insurance issue. It seldom includes a discussion of the actual business of insurance. The subject and content of every speech of Superintendent Lawsky over the past two years, available on the DFS website, is about banking or Wall Street, and any reference to insurance is merely incidental to his main topic.

Which raises the question of how and why the insurance business has become the stepchild of banking under the DFS. This evolution makes no sense from a state economic perspective. According to its 2013 annual report, the DFS collected almost $1.3 billion in revenues. About $368 million of the total were one-off fines and penalties against both banks and insurers, but the number is not broken down between the two. Over 90% of the remaining $900+ million in revenues were derived from the insurance industry and its customers. For instance, insurance industry assessments totaled $394 million (compared to $76 million for banking industry assessments). Also, surplus lines taxes collected exceeded $75 million; motor vehicle law enforcement fees exceeded $120 million; and foreign fire taxes and security fund receipts exceeded $205 million for the year. There were few comparable categories of receipts for the banking business in New York. This disparity is not unexpected, given that the DFS has primary regulatory authority over the insurance business in the state while its authority over the banking industry is limited to state chartered banks and is secondary to the federal regulators. But you would never know it by following DFS activities or reading the Superintendent's speeches.

New York is not the first state to have combined insurance within a broader regulatory framework. New Jersey, for instance, combined banking and insurance under one regulatory roof long before New York. Other states have also seen the value in a broader perspective, including effi-

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ciencies in management and resources. In Alaska insurance is a division of the department of commerce, community and economic development; in Michigan it is the department of insurance and financial services; and in Vermont it is the department of financial regulation, to name just a few. But in all these states, insurance understandably continues to be the main focus of the regulators. Superintendent Lawsky would argue, of course, that New York has a far greater concentration of banks and other financial service businesses than other states, and expanding the State's regulatory reach over these entities is important to protect the State's status as the principal financial center in the US. Even if one accepts that position – and I suspect that many financial industry leaders and federal regulators do not – expanding the reach of state regulators over banking and other financial entities should not eclipse a state's historic relationship with the insurance industry.

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It is hard to imagine that New York's lawmakers envisioned a combined banking and insurance department like the bank-centric agency that the Department of Financial Services has become. It is equally hard to understand the ultimate goal in this approach. In a highly regulated business like insurance, a healthy relationship between regulator and regulated is essential to maintain a robust industry. Ignoring the insurance industry and its historically stable revenue stream to focus on a base – state licensed banks – that cannot be significantly expanded or that is penalty revenue dependent, is not a sound business model.

Try as it might, the tail cannot wag the dog! [IA]

UPDATE: The "technical adjustment" legislation referred to in my last column, "*The Sausage Factory*," was overwhelmingly passed by both houses of the NY Legislature and signed into law by Governor Cuomo on March 13, 2015, a little over a month after the bill was introduced in the Legislature. Decades to solve a problem undone in 30+ days?

Peter Bickford has over four decades of experience in the insurance and reinsurance business, with particular focus on regulatory, solvency, agency, alternative market and dispute resolution issues. In addition to his experience as a practicing attorney, he has been an executive officer of both a life insurance company and of a property/casualty insurance and reinsurance facility. A complete biography for Mr. Bickford may be accessed at www.pbnylaw.com.