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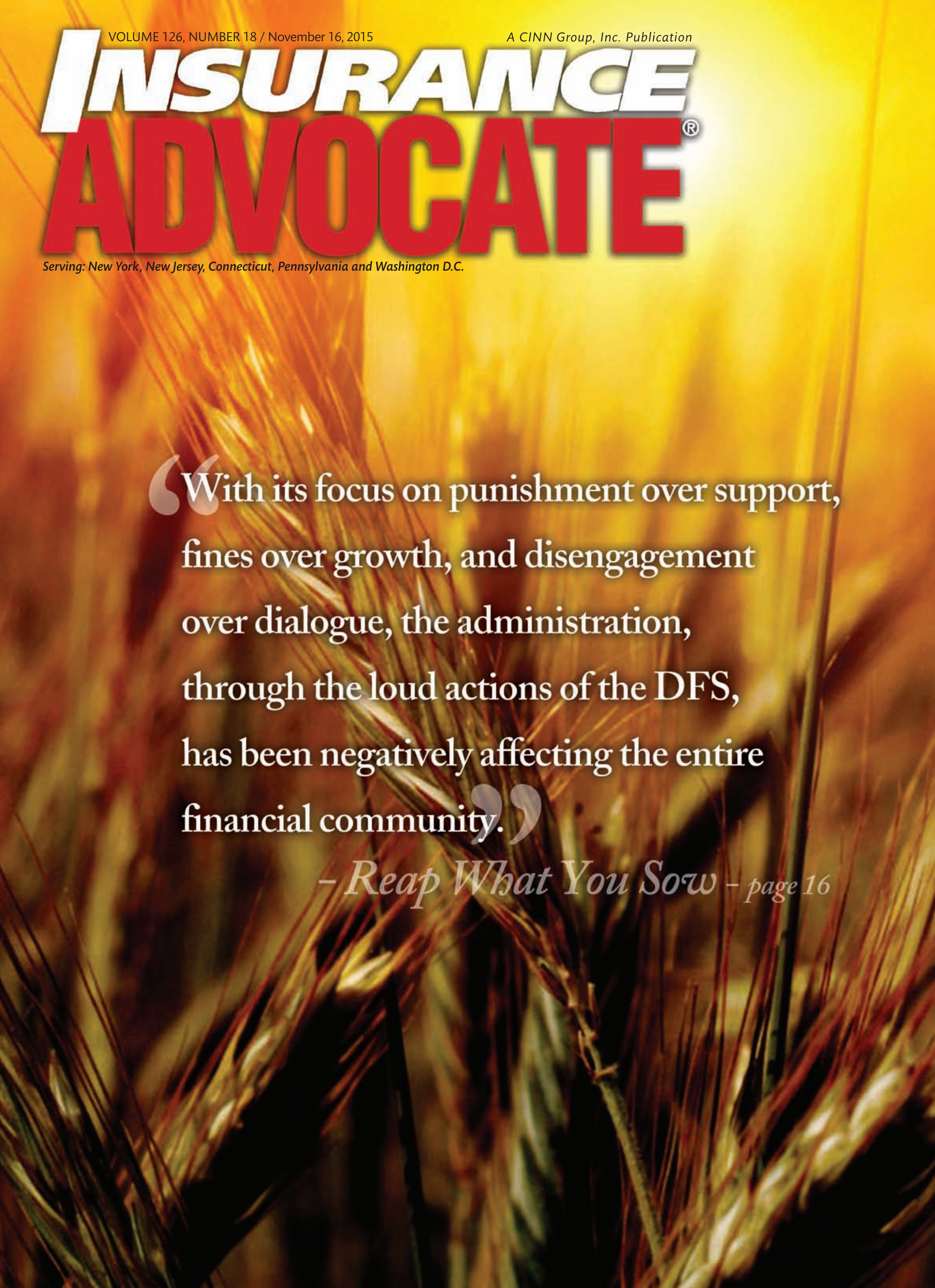

"With its focus on punishment over support, fines over growth, and disengagement over dialogue, the administration, through the loud actions of the DFS, has been negatively affecting the entire financial community."

– Reap What You Sow – *page 16*

 By Peter H. Bickford

REAP WHAT YOU SOW

The Wall Street Journal has – wittingly or unwittingly – underscored the conundrum that is NY's Department of Financial Services. Its October 26 article headed "New York Bank Regulators Exit After Clash With Governor Cuomo's Office," reporting on the resignation of the Department's acting superintendent, makes no reference at all to insurance. The October 30 follow-up article, headed "Banking Job is Tough to Fill" includes a statement by a spokesperson for the Governor that the administration "is conducting a robust and thorough search for the right person to ensure DFS's strong enforcement of the rules of the road for Wall Street continue and lead the agency into the future." Again, no mention of insurance.

An outsider reading these columns would have no clue that the DFS is responsible for regulating insurance as well as banking, or that the DFS is the primary regulator of insurance companies doing business in the state while it is not the primary regulator of most banks doing business in the state – it just seems that way. For instance:

- You would not know that insurance companies generated $2.4 billion in revenues for the state in 2014, including $1.4 billion in premium, franchise and related taxes; and about $1 billion in assessments and other fees (NAIC 2014 Insurance Department Resources Report).
- Nor would you suspect that DFS revenues from insurance are about four times DFS revenue from banks (DFS 2014 Annual Report).
- And you would have no idea of the reach of the industry to Mainstreet USA, including the fact that in 2014 DFS issued over 180,000 licenses to agents, brokers, adjusters and others dependent on the insurance industry for their livelihood (DFS 2014 Annual Report).

But the marginalization of insurance by DFS is only part of the problem. The enforcement mentality of the new wave of regulators affects the entire financial service sector of which insurance is an important piece. With the focus on punishment over support, fines over growth, and disengagement over dialogue, the administration, through the loud actions of the DFS, has been negatively affecting the entire financial community. This negative impact is not just at the c-suite level (a term DFS spokespeople love to use), but also for all the people employed by or dependent on those businesses by discouraging job stability and economic development.

A June 2015 study by The Partnership for New York City titled "At Risk: New York's Future as the Financial Capital of the World" observed:

> The [financial services] industry continues to favor New York as a place that provides excellent access to both talent and customers, a relatively stable business environment, and many lifestyle amenities. But there are rising concerns about high costs, high tax rates, aging infrastructure and a hostile political and regulatory climate. Survey responses suggest that, absent public actions to address these concerns, the city's future as the world financial capital is at risk."

By the time this article is published a new superintendent of financial services may have been designated, and the expectation may again echo these recent pronouncements focused on policing Wall Street and void of insurance industry references. But there is also the hint that the administration has recognized the negative consequences of its singular focus on enforcement to the detriment of economic development and may be considering a course adjustment.

The purpose of the DFS as detailed in Section 102 of the Financial Services Law is to "provide for the enforcement of the insurance, banking and financial services laws, under the auspices of a single state agency" and to accomplish goals that include the following:

> "(a) To encourage, promote and assist banking, insurance and other financial services institutions to effectively and productively locate, operate, employ, grow, remain, and expand in New York state;
>
> "(b) To establish a modern system of regulation, rule making and adjudication that is responsive to the needs of the banking and insurance industries and to the needs of the state's consumers and residents; . . .
>
> "(e) To promote and provide for the continued, effective state regulation of the insurance industry; . . .
>
> "(h) To promote, advance and spur economic development and job creation in New York; . . . and
>
> "(l) To educate and protect users of banking, insurance, and financial services products and services through the provision of timely and understandable information."

Who remembers that the original version of the 2011 bill merging the banking and insurance departments was titled the "Financial Regulation and Protection Law" and the DFS was to be known as the "department of financial regulation"? Who remembers that the insurance industry lobbied to tone down the enforcement aspects of the new law in an attempt to achieve a more balanced regulatory framework? Reviewing the first four years of the DFS one would be hard-pressed to find meaningful examples of efforts by it to fulfill any of these goals, as the emphasis has been almost entirely on the goal of enforcement.

A number of critics have jumped on the recent resignations as evidence of a pattern of improper micromanaging by the Governor over the investigative authority of the agency. However, this brouhaha over control of the DFS is misplaced. The DFS is a state administrative agency whose head is appointed by and reports to the governor. The superintendent is an arm of the administration and not separate and independent from it. The governor is entitled to appoint people who reflect his objectives. If those objectives change, the governor is entitled to change the head of the agency. If the people of the state do

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BUT THERE IS ALSO THE HINT THAT THE ADMINISTRATION HAS RECOGNIZED THE NEGATIVE CONSEQUENCES OF ITS SINGULAR FOCUS ON ENFORCEMENT TO THE DETRIMENT OF ECONOMIC DEVELOPMENT AND MAY BE CONSIDERING A COURSE ADJUSTMENT.

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not like the goals or policies of the administration, they can elect a new governor. This seems so basic to our democratic process, yet the howling about interfering with the independence of the DFS has been intense.

Even with all the noise about continuing the strong policing of Wall Street, and even if the Governor appoints a new head of DFS with a strong enforcement background, there is also the possibility that underlying the recent changes is the recognition by the administration that some kind of reboot is necessary. There is the prospect that the administration has come to recognize that mega-fines are not sustainable long-term, that financial services industries will not accept regulation by enforcement forever, that New York's prominence as a financial leader is in jeopardy, that its policies are having a dilatory effect on job creation and economic development, and that there needs to be a return to effective regulation designed to support the industry and help encourage its growth and standing in the economy as well as root out wrongdoers.

If the administration has finally recognized that only by planting the seeds of growth and development can it harvest their benefits, here are a few seeds it might like to consider sowing at DFS:

- DFS should start by being a far more transparent agency. During its four-year life it has undone decades of open communication with industry and consumers, including eliminating most of the information about the business of insurance in its statutorily required annual report (substituting instead a litany of its own perceived "accomplishments"), ceasing to issue guidance through departmental opinions, and generally focusing on enforcement to the exclusion of day-to-day industry and consumer issues.
- Make its website far more user friendly for businesses and consumers, and improve access to information. A good starting point would be to post all regulations for free access, scrapping outdated contracts with publishers that limit access to a for-pay basis only. DFS is a public agency and the public should have free access to its regulations and rulings.
- Restart DFS's early efforts to improve the backlog of rate and form filings, including resurrection of the Filing Modernization Project and other initiatives to improve efficiencies within the agency.
- Don't be so paranoid about the surplus lines markets, including the domestic "free trade zone." These markets are essential and valuable resources for NY residents and businesses, particularly those with unusual or hard to place risks.
- Support, or at least explore with an open mind, new industry and capital market initiatives, such as permitting domestic surplus lines operations, re-establishing a syndicated insurance risk exchange, and encouraging rather than discouraging non-traditional capital investment. Alternative markets and non-traditional capital investments offshore have been draining resources from NY and the rest of the US for far too long. It is time to embrace efforts to help restore NY as a financial leader and not just be its police.
- Explore avenues to strengthen an Achilles Heel of state regulation of insurance as identified by the Federal Insurance Office: its guaranty fund system. NY can be a national leader in addressing the inconsistencies in guaranty fund coverages and funding, particularly with the treatment of annuities, which are more and more being used as alternative funding vehicles for pensions outside of the protection of Federal Law.
- Most importantly, improve dialogue with industry, consumers and capital markets.

It may be some time before we have any clarity regarding the future direction of the DFS and its treatment of the insurance industry. We can only hope that recent events include a recognition of the need to improve relations with the industry, and that the cry for DFS to continue to be the Wall Street police can be tempered with a realistic need for balance. DFS does not have to totally yield on enforcement to improve the regulatory atmosphere. Rooting out bad guys is good for everyone (except the bad guys). But regulation has to be balanced.

EVEN WITH ALL THE NOISE ABOUT CONTINUING THE STRONG POLICING OF WALL STREET, AND EVEN IF THE GOVERNOR APPOINTS A NEW HEAD OF DFS WITH A STRONG ENFORCEMENT BACKGROUND, THERE IS ALSO THE POSSIBILITY THAT UNDERLYING THE RECENT CHANGES IS THE RECOGNITION BY THE ADMINISTRATION THAT SOME KIND OF REBOOT IS NECESSARY.

Removing weeds and weevils from regulatory fields containing no seeds for growth and development will in time turn the fields irrevocably fallow.[IA]

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.