

FEDERATION OF REGULATORY COUNSEL, INC.

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CURRENT DEVELOPMENTS IN HEALTH INSURANCE RATE REGULATION

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In the past year at least four states, California, Colorado, Georgia and Washington, introduced legislation to require the prior approval of health insurance rates.¹ In connection with implementing price controls on rates, these laws often create new reporting requirements to increase so-called "transparency" of health insurance expenditures. The apparent goal of those sponsoring the legislation is to make health insurance more affordable and thereby decrease the number of uninsured. However, several studies indicate that adding additional layers to existing regulatory oversight in this manner is unlikely to achieve lower premiums for consumers or give consumers the information that will assist them in making knowledgeable, appropriate choices regarding their health care.

OVERVIEW OF RECENT STATE LEGISLATION PROPOSING PRIOR APPROVAL OF HEALTH INSURANCE RATES

In 2007, legislation introduced in California would have required health plans and health insurers licensed by the California Department of Managed Health Care and the California Department of Insurance to file rate increases 60 days prior to implementation.² The sponsor of the bill stated the law was "necessary to control health care premium increases that outpace general and medical inflation," and "health plan overhead, including administrative costs and profits, contributes to high costs."³ In addition to implementing prior approval for rate increases, the legislation sought to elicit financial information such as average rate per enrollee, overhead, loss ratio, reserves, medical expenses, salaries, and bonuses.⁴ The legislation failed to pass out of the legislature.

Colorado's Legislation "Concerning Increased Oversight Of Insurance Rates" (a.k.a. "Fair Accountable Insurance Rates"), as introduced, would require health and automobile insurance rate filings that propose a rate increase to be made 60 days prior to implementation.⁵ The commissioner of insurance could disapprove the rates "for good cause" after the 60 days expired. Additionally, any rate filing increases filed between March 1, 2007, and January 1, 2009, would be subject to review and disapproval on a retroactive basis.⁶ The bill would also require insurers to report whether the proposed rate increase was attributable to an increase in a lengthy list of costs.⁷ The bill provides standards for the commissioner to consider during a rate review, including "benefits ratios," and creates a private right of action against insurers who violate the rate filing law.⁸ The bill is intended to "require insurance companies to justify their rate increases, giving the Division of Insurance the right to take into account incidence of claims, surplus reserves and other financial factors," and provide "a full financial picture" of insurers.⁹ The sponsor stated, "by requiring private insurers to justify proposed increases . . . companies are likely to bring down or at least slow the rate of premium increases that have forced thousands of people to drop insurance coverage in recent years."¹⁰ An amended version of this bill, applying only to health insurance rates, was signed into law on June 6, 2008 and becomes effective July 1, 2008 for rates that go into effect after January 1, 2009.

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In Georgia, Commissioner John W. Oxendine proposed legislation that would have required filing of health insurance rates 90 days in advance of use.¹¹ While the commissioner could approve the rate filing before the expiration of 90 days, the commissioner would have the option to extend the review period for an additional 90 days.¹² This review period could conceivably continue indefinitely if the commissioner ordered an examination of a filing.¹³ When the legislation was introduced, Commissioner Oxendine stated that, if enacted, the DOI would be "able to make sure insurance companies are held accountable when they file health rate increases" and would "be empowered to hold the line on increases, and make sure that health rates are in line with market realities."¹⁴ The legislation failed to get out of committee.

The Governor of Washington signed legislation on April 1, 2008, that requires insurers to wait 60 days after filing to use rates or rate modifications for individual health plans.¹⁵ The law also requires health plans to maintain a medical loss ratio of 74 to 77% depending on the declination rate. ¹⁶ Supporters of the law "hope the bill will put a brake on rising premiums."¹⁷

UNINTENDED CONSEQUENCES OF PRIOR APPROVAL AND TARGETED LOSS RATIOS

As noted above, in each of these states, the intended effect of the prior approval laws was to reduce or halt increases in health insurance rates. The proponents of the legislation assert not enough of premium dollars are being spent on health care, but instead are going to administrative costs, such as executive salaries, profits and allegedly to pay for computer software to deny claims.¹⁸ Moreover, in an apparent effort to control the cost of insurance, these laws include loss ratio targets and seek disclosure of insurer expenditures. As will be discussed, studies and academic literature indicate that prior approval laws have been shown to result in higher costs, decreased availability and increased numbers of uninsured. Research also shows that insurer loss ratio levels are not an indicator of quality or efficiency of health care delivery. Finally, these legislative efforts are also unlikely to result in providing consumers with a better understanding of price and quality of healthcare providers.

Neither prior approval of health insurance rates nor targeted loss ratios deal with the real drivers of health costs and consequently such laws fail to control premiums in a meaningful manner. A discussion of the many components and factors affecting the cost and delivery of healthcare is beyond the scope of this article; however, many studies conclude that health costs are increasing due to increased utilization by consumers and due to advances in technology that drive provider rate increases.¹⁹ National health insurers report that 79 to 80 cents of every health care dollar is currently used to reimburse doctors, hospitals and other providers for medical services.²⁰ Of the remaining portion of each dollar, 11 cents goes to administering health plans, 4 cents goes to taxes and 6 cents is profit, which goes to shareholders as dividends, is used for charitable giving and is reinvested in the business.²¹

An in-depth analysis of the impact of prior approval requirements for rate changes in California, by Mercer Oliver Wyman, concludes that prior approval, a form of price control, is likely to result in: higher premium prices, reduced access to health care services as a result of less competition, less consumer choice of insurance products and more uninsured.²² The study also examines the experience of three states that implemented rate restrictions on health insurers, Kentucky, Washington and New York. In each state, premiums increased, carriers abandoned the individual market, costs went up due to the long and expensive rate approval process and the uninsured population increased as purchase of individual insurance decreased.²³ Thus, delaying or blocking actuarially justified rate increases does not in the long run appear to provide consumers with more affordable health insurance.

Another method advocated to control rates involves targeted loss ratios. A loss ratio "measures the fraction of total premium revenue that health plans devote to clinical services, as distinct from administration and profit."²⁴ The argument for codifying targeted loss ratios is based on the theory that a low loss ratio suggests a health insurer is not directing enough of the premium dollar to health care and is instead directing the

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premium towards administration or profit.²⁵ This conclusion greatly oversimplifies the issue and disregards the benefits that can be provided to consumers through administrative expenditures, such as disease management programs or anti-fraud efforts.²⁶ Importantly, because it is simply a ratio of spending to revenues, the medical loss ratio does not provide a clear picture of either medical or administrative expenditures or waste.²⁷ It also ignores the differences between and among indemnity and managed care companies and plans and gives no indication of quality.²⁸

The demand for greater disclosure by health carriers of where the dollars are spent is connected to the call for targeted loss ratios. However, increased, and often redundant, reporting requirements will not inevitably provide greater understanding for consumers of health insurance. Regulators already mandate myriad reporting requirements for carriers, and they also collect information through existing mechanisms. Regulators conduct market and financial conduct exams of insurers to verify compliance with the laws enacted to protect consumers in their insurance transactions. Furthermore, information on numerous aspects of insurance company operations already exists. States such as Colorado require reporting of complaint ratios.²⁹ The state also publishes an annual insurance industry statistical report that includes information on assets, liabilities, capital and surplus, net/loss gain, market share percentage, loss ratios and premiums earned.³⁰ Regrettably, such data is not provided in a manner that is easy to understand or access. Increasing the amount of information available without placing it in a meaningful context will not solve the issue of transparency for consumers.

CONCLUSION

Implementing prior approval of health rates or mandated loss ratios will not result in lower insurance rates. Consumers will not benefit from knowing how much a carrier spends on defense litigation costs, lobbying efforts or shareholder dividends.³¹ In the health care context, consumers want to know about prices and quality of providers. The challenge of reform should be on aggregating existing data in a format that is easy to locate and understand for all stakeholders, rather than increasing administrative costs related to oversight and compliance.³²

Endnotes

1. California A.B. 07- 1554, Colorado H.B. 08-1389, Georgia H.B. 08-923/S.B. 08-380, Washington S.B. 07-5261.
2. California A.B. 07- 1554, § 1.
3. See, Bill Analysis, Comments available at: http://info.sen.ca.gov/pub/07-08/bill/asm/ab_1551-1600/ab_1554_cfa_20070515_162540_asm_comm.html(last visited Apr 16, 2008).
4. A.B 07-1554, *supra* note 2.
5. Colorado H.B. 08-1389, §§ 6 & 13.
6. *Id.*
7. *Id.*

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8. *Id.* at §§ 7, 8 &, 13.
9. *See* Tim Hoover, Democrats Unveil New Health Bills, THE DENVER POST (Mar. 31, 2008), available at: http://www.denverpost.com/news/ci_8752374(last visited Apr. 16, 2008).
10. *See* Ed Sealover, Bills Add Insurance Rate Hike, Claims Oversight, THE GAZETTE (Mar. 31, 2008), available at: http://www.gazette.com/articles/insurance_34816_article.html/companies_health.html(last visited Apr. 16, 2008).
11. Georgia H.B. 08-923/S.B. 08-380, § 3.
12. *Id.*
13. *Id.*
14. Health Insurance Reform Legislation Will Hold Line on Rate Increases, THE FOREST BLADE, (Jan. 30, 2008), (copy on file with author).
15. 2008 Wa. ALS 303; 2008 Wa. Ch. 303.
16. *Id.* at §5, RCW 48.44.017; The law states: "'Declination rate' for a health care service contractor means the percentage of the total number of applicants for individual health benefit plans received by that health care service contractor in the aggregate in the applicable year which are not accepted for enrollment by that health care service contractor based on the results of the standard health questionnaire administered pursuant to RCW 48.43.018(2)(a)."
17. *See* Kyung M. Song, Bill To Rein In Individual Health Plans Advances, THE SEATTLE TIMES (Mar. 15, 2008), available at: http://seattletimes.nwsourc.com/html/politics/2004258291_insurance04m.html.
18. *See* Tim Hoover, *supra* note 9.; Bob Mook, Democrats Push For Health Care Reform, DENVER BUSINESS JOURNAL (Mar. 31, 2008), available at: <http://www.bizjournals.com/denver/stories/2008/03/31/daily15.html>(last visited Apr. 16, 2008).
19. *See* e.g. Health Care Costs: A Primer, Key Information on Health Care Costs and Their Impact, KAISER FAMILY FOUNDATION at 12. (Aug. 2007), available at: <http://www.kff.org/insurance/upload/7670.pdf>(last visited Apr. 17 2008); PricewaterhouseCoopers, Factors fueling Rising Health Care Costs 2006 at 9-11. (Jan. 2006) available at: <http://www.ahipbelieves.com/media/The%20Factors%20Fueling%20Rising%20Healthcare%20Costs.pdf>(last visited Apr. 17 2008).
20. *See* e.g. How Aetna Spends Each Health Care Premium Dollar, (2006/2007) on file with author.
21. *Id.*
22. Karen Bender & Beth Fritchen, Impact of Prior Approval Requirements for Rate Changes of Small Employer Group and Individual Health Policies, MERCER OLIVER WYMAN at 1. (Jan. 2004).
23. *Id.* at 19.
24. James C. Robinson, Use And Abuse Of The Medical Loss Ratio To Measure Health Plan Performance HEALTH AFFAIRS, Vol. 16, No. 4 (1997) at 176.

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25. *Id.* at 178-179.
 26. See J.P. Wieske, How High Loss Ratios Undermine Affordable Health Insurance, THE COUNCIL FOR AFFORDABLE HEALTH INSURANCE'S ISSUES & ANSWERS, No. 141 at 1-2, (May 2007).
 27. James C. Robinson, *supra* note 24 at 178.
 28. *Id. passim.*
 29. C.R.S. § 10-16-409; See http://www.dora.state.co.us/pls/real/Ins_Comp_Ratio_Report.Home.
 30. Available at: <http://www.dora.state.co.us/insurance/pb/supporting%20documents/2006%20Stat%20Rpt.pdf>
 31. See Colorado H.B. 08-1389, § 6.
 32. See James C. Robinson, *supra* note 24 at 186.
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NATIONAL TRENDS AFFECTING PRODUCER LICENSING

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Introduction 1

Uniformity and/or reciprocity for producer licensing has long been a goal of the National Association of Insurance Commissioners and its member states. Unfortunately, it has been somewhat challenging to achieve meaningful uniformity and reciprocity in a number of areas, and much that has been achieved was only due to the threat of Federal intervention. Nonetheless, there are a number of new initiatives underway which seek greater uniformity and reciprocity. As to the likelihood of success for these various initiatives, it is simply too early to tell.

Before evaluating the various initiatives, it is helpful to understand a few key concepts with regard to producer licensing. The concept of uniformity relates to resident licensing. For example, if an individual seeks his or her initial (home state or resident) license in State X, will the licensing process be the same as if he or she lived in State Y? The NAIC has adopted 37 Uniform Resident Licensing Standards that focus on 8 broad areas, including (1) licensing qualifications; (2) pre-licensing education; (3) licensing testing; (4) integrity/background check standards; (5) license application process; (6) appointment process; (7) continuing education requirements; and (8) limited lines.

Reciprocity on the other hand addresses non-resident licensing. Once licensed in his or her home state or resident state, can the producer easily and efficiently obtain non-resident licenses in the remaining jurisdictions? The NAIC has identified four conditions that a state must satisfy in order for the state to be considered "reciprocal."²

The original push for uniformity and reciprocity came to a head in the late 1990s with the enactment of the

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Gramm-Leach-Bliley Act ("GLBA") and its threat to regulate producer licensing through the creation of a National Association of Registered Agents and Brokers ("NARAB") if greater state producer licensing uniformity or reciprocity was not developed. In an effort to preserve state regulation, the NAIC worked to increase licensing reciprocity through promulgation and widespread adoption of the Producer Licensing Model Act (the "PLMA") beginning in 2000. By 2002, the requisite number of jurisdictions adopted sufficient portions of the PLMA to avoid the NARAB trigger under GLBA.

In 2007, the NAIC identified producer licensing reform as one of the NAIC's key strategic issues. As a result, the NAIC conducted a national, comprehensive producer licensing assessment discussed in Section I below and issued the NAIC Producer Licensing Assessment Aggregate Report of Findings ("Report"). Following the release of the Report, the NAIC Executive Committee reconstituted the NARAB Working Group (see Section II) and the NAIC Producer Licensing Working Group, through a sub-group, began working on a Producer Licensing Handbook (see Section III). But the NAIC is not alone in these efforts. The National Conference of Insurance Legislators ("NCOIL") has also stepped into the fray (see Section IV), and the Federal Government may also become involved again (see Section V).

I. NAIC Producer Licensing Assessment Aggregate Report of Findings

On February 19, 2008, the NAIC Producer Licensing Working Group (the "PL Working Group") released its comprehensive assessment of the producer licensing laws, practices and processes throughout the United States. The Report focuses on the reciprocity and uniformity -- or lack thereof -- that currently exists across the fifty states, the District of Columbia, and Puerto Rico. It serves as a snapshot of the nation's producer licensing regulation, highlighting areas where uniformity and reciprocity is found and pointing out not only where uniformity or reciprocity is lacking, but also providing suggestions for overcoming roadblocks to increased interstate consistency.

The assessment team -- volunteer insurance regulators (including: commissioners, directors, superintendents, senior regulator staff, and licensing directors) visited all fifty-two jurisdictions over a short three month period. The Report serves as an independent legal review and on-site peer assessment of all U.S. producer licensing laws and practices.

The Report contains notable findings regarding the following issues:

- **Gramm-Leach-Bliley Act.** The Report finds that forty-three states (three more than originally believed) are compliant with the reciprocity standards established in 2002 in light of GLBA.
- **Uniform Resident Licensing Standards.** In order to assess the uniformity of producing licensing procedures across states, the PL Working Group evaluated the states' compliance with the thirty-seven "Uniform Resident Licensing Standards" (the "Standards"). Each state's licensing procedures were examined against those Standards. If at least thirty-five states were found to satisfy a particular Standard, the PL Working Group deemed it an area of "high compliance." Conversely, where less than thirty-five states satisfied a Standard, "low compliance" was found. The Report found high compliance in twenty-six of the Standards and low compliance in eleven. According to the Report, the most common reasons for low compliance include: the need for state legislative action; differing interpretations of uniform licensing provisions; and lack of local industry support for change.
- **Secretary of State Registration.** At the behest of industry representatives, the PL Working Group examined the elimination of secretary of state registration requirements. The Report addresses the source of such requirements, the impediments to elimination, and the slow-but-steady eradication of this requirement by the states.
- **Business Entity Licensing.** The increased streamlining of business entity licensing is another topic of industry interest that was examined by the PL Working Group. The Report contains an in-depth review of the variance of business entity licensing requirements among jurisdictions, followed by a

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list of recommendations for further alignment of the business entity licensing process.

- **Industry-Specified Concerns.** The PL Working Group evaluated each jurisdiction's laws and practices against a compilation of research performed by various national producer trade associations. The Report serves to identify and examine the impediments to reciprocity that exist in a significant number of states, as opposed to other issues identified by the trade associations that exist only in two states or less.

In completing the 53-page Report, the assessment team noted issues worthy of consideration by future multi-jurisdictional assessment endeavors. The final section of the Report contains a discussion of those issues, including a discussion of issues now ripe for attention by state insurance commissioners and superintendents.

A copy of the full Report is available at the NAIC webpage:

http://www.naic.org/Releases/2008_docs/producer_licensing_assessment_report.pdf

II. NAIC NARAB (EX) Working Group

Following the issuance of the Report, the NAIC Executive Committee reconstituted the NARAB (EX) Working Group ("NARAB Working Group"), which held its first meeting on March 31, 2008. The NARAB Working Group has been given three charges by the Executive Committee:

1. Evaluate the reciprocity status of states that are not currently certified as reciprocal but whose producer licensing laws have been reviewed by the NAIC Legal Division as eligible for reciprocity certification;
2. Evaluate the reciprocity standards adopted in 2002 and recommend any revisions or changes to address the issues identified in the Report; and
3. Evaluate key findings and issues regarding disparate business entity licensing laws, regulations and practices identified in the Report and provide policymaking recommendations for simplifying and standardizing the business entity licensing process.

The goal is to complete charges 1 and 2 by the summer NAIC meeting, and charge 3 by the fall NAIC meeting. Whether the NARAB Working Group will be able to complete these tasks in the time recommended is uncertain. Regardless, state implementation of any recommendations relating to business entity licensing arising from charge 3 above may take years to be broadly adopted by a substantial number of states.

III. NAIC State Producer Licensing Handbook

On February 29, 2008, the NAIC issued a first draft of the NAIC State Licensing Handbook ("Handbook"). This Handbook is primarily the work of Roseanne Mead of Iowa and is intended to be adopted by the PL Working Group after comments have been received.

The Handbook is intended to be a single source of information relating to the PLMA and producer licensing in general. It will provide meaning to, and gather relevant information concerning, the PLMA and the Uniform Resident Licensing Standards. For example, the Handbook includes at pages 20-21 a table which restates the Implementation Guidelines of the PLMA dated August 27, 2000, which provide examples of licensable agent acts versus non-licensable clerical acts.

The Handbook is comprised of three main parts, Insurance Producer Licensing, Miscellaneous Licenses and a Glossary. Many of the chapters of the Handbook have "best practices" which generally show how uniformity and / or reciprocity can be improved. In that sense, it is similar in some respects to the work of the NARAB Working Group discussed in Section II above.

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IV. NCOIL

The National Conference of Insurance Legislators ("NCOIL") has also weighed in on the topic of improving the producer licensing system. NCOIL is an organization of state legislators whose main area of public policy interest is insurance legislation and regulation. NCOIL oftentimes works in tandem with the NAIC on issues of importance, although on occasion, NCOIL and the NAIC have had substantive disputes on issues.

On March 1, 2008, NCOIL adopted a "Resolution in Support of the National Insurance Producer Registry" ("NIPR")³ and urged all states to fully implement NIPR services in an attempt to eliminate unnecessary hurdles in producer licensing. The resolution provides, among other items, that NCOIL:

- Embraces NIPR's efforts to create an online, one-stop licensing resource for insurance agents and brokers nationwide
- Supports the goals and objectives of NIPR and is committed to helping create a truly reciprocal licensing system that enables qualified producers to obtain and renew licenses promptly
- Urges state legislators to use their authority to ensure that state insurance departments are utilizing and offering the functionality and services that NIPR is making available.⁴

Virtually all of the producer trade associations, such as the Independent Insurance Agents and Brokers of America (IIABA), National Association of Health Underwriters (NAHU), National Association of Insurance and Financial Advisors (NAIFA), and the National Association of Professional Insurance Agents (PIA), supported the NIPR resolution.

The resolution was adopted a day after NCOIL met with NAIC representatives to discuss the Report (covered in Section I above).

V. All for Naught? NARAB II

Despite the widespread adoption of many of the provisions of the PLMA, there have been rumblings for some time that the hoped-for uniformity was never fully recognized. These rumblings have now been brought back to the fore, with the introduction of a national producer licensing initiative that is being dubbed "NARAB II." This new legislation was introduced in the U.S. House of Representatives on March 13, 2008 with a bipartisan proposal, H.R. 5611 (the "Bill"), sponsored by Rep. David Scott (D-Ga.) and Rep. Geoff Davis (R-Ky.).

The Bill would again create a NARAB, a private, independent, nonprofit corporation existing under District of Columbia law, but this time contains no escape hatch, even if greater uniformity and/or reciprocity is attempted by state regulators. If enacted, the Bill is intended only to create true licensing reciprocity for those insurance producers who conduct business in multiple states. States would still retain authority to regulate marketplace activity and enforce consumer protection laws. Furthermore, the Bill only displaces the state licensing system outside of a producer's home state (i.e., generally the producer's resident state). As such, it generally applies only to non-resident licensing and does not affect resident licensing.

A release issued by Reps. Scott and Davis indicates that they believe that passage of the Bill would lead to increased competition among producers, and thus benefit consumers through greater consumer choice. Small businesses -- specifically, insurance brokerages and agencies -- are also expected to benefit from the streamlining of the non-resident licensing regulations.

Under the legislation, producers would become eligible to join NARAB by holding (or obtaining) a home state license. Once a member, they would obtain authority to "sell, solicit, negotiate, effect, procure, deliver, renew, continue or bind insurance" in any state for the same line or lines of insurance covered in their resident license. The only prerequisite would be that they pay non-resident licensing fees to NARAB, which would be

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remitted to the appropriate non-resident states. No state, except for the producer's home state, would be allowed to deny a license to any NARAB member in good standing or require a NARAB member to obtain a business entity license or membership. However, all states (both resident and non-resident) would still have authority to regulate market conduct and enforce consumer protection laws.

The Bill leaves the development of further criteria for membership to the NARAB Board. In this regard, the Board would generally have the power to establish standards regarding personal qualifications, continuing education, training and experience. In establishing the membership criteria, the Board would be authorized to draw from relevant state licensing laws regarding insurance producer qualifications and could deny membership in instances where a producer's resident license had been suspended or revoked during the preceding three years or where information obtained from a national criminal history record check indicated that membership should be denied. Finally, NARAB membership would also be conditioned upon continuing education requirements comparable to those used by a majority of the states. NARAB members would be exempt from nonresident states' continuing education requirements, and the bill contains provisions designed to prevent duplicative continuing education requirements between NARAB and a producer's home state.

Chartered as a nonprofit organization, NARAB would be overseen by a board of nine members, including four state insurance commissioners, three members appointed by insurance producer trade associations, one member appointed by property/casualty trade groups and one member appointed by life and health trade groups. NARAB would not be part of any federal agency, would not report to any federal agency, and would not have any federal regulatory power.

As opposed to some of the more broad-sweeping proposals regarding federalization of insurance regulation, this Bill is limited to the narrow area of uniformity in nonresident producer licensing. The Bill's narrow focus makes it one to watch, as it may have a greater likelihood of enactment when compared to broader, and therefore more controversial, nationalization efforts.

Conclusion

The challenge of greater uniformity and reciprocity for producer licensing still exists, but as can be seen here, the regulators are (1) aware of many of the issues and (2) attempting to implement changes to increase uniformity and reciprocity. Nonetheless, there remains, at least for now, the threat of possible Federal intervention on these issues.

Endnotes

1. The author would like to thank Ethan Lenz and Ben Thomas for their assistance with this article.
2. In order to be considered reciprocal for non-resident producer licensing, a state must satisfy the following four conditions: (1) Permit a producer with a resident license for selling and soliciting insurance in its home state to receive a license to sell or solicit the purchase of insurance as a non-resident to the same extent that the producer is permitted to sell or solicit insurance in its home state, if the home state also licenses reciprocally, without satisfying any additional requirements other than submitting (a) a request for licensure; (b) the application for licensure submitted to the home state; (c) proof of licensure and good standing in home state; and (d) payment of any requisite fee; (2) Acceptance of a producer's satisfaction of its home state's continuing education requirements as satisfying that state's continuing education requirements, provided that the home state recognizes continuing education satisfaction on a reciprocal basis; (3) No requirements are imposed upon any producer to be licensed or otherwise qualified to do business as a non-resident that have the effect of limiting or conditioning that producer's activities because of its residence or place of operations

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(excepting countersignature requirements); and (4) Each state meeting (1), (2), and (3) grants reciprocity to residents of all other states that satisfy (1), (2), and (3).

3. NIPR is a non-profit affiliate of the NAIC that administers the Producer Database (PDB) and provides for electronic appointments and terminations in an effort to bring electronic licensing efficiency to producer licensing.

4. NCOIL Press Release, March 4, 2008.

TREASURY DEPARTMENT'S BLUEPRINT FOR INSURANCE REGULATION OVERHAUL

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On March 31, 2008, in its "Blueprint for a Modernized Financial Regulatory Structure," the U.S. Department of the Treasury outlined a vision for overhauling the framework that regulates U.S. financial markets, including the insurance industry, to establish a more comprehensive and integrated system.² The Blueprint is a dramatic initiative that addresses federal versus state regulation of insurance and recommends the establishment of an optional federal charter for insurers and insurance producers. The proposed overhaul has international consequences and would empower the federal government to address any insurance issue deemed "international." While the Blueprint seems an ambitious effort to launch in the closing months of the Bush administration, the U.S. Congress has already been prompted to introduce legislation to address international issues and to harmonize state regulatory responses on the national level.

Overview of the Blueprint

The stated goal of the Blueprint is to introduce a more comprehensive approach to the regulation of the U.S. financial landscape. Because of their varying degrees of urgency, Treasury divided its recommendations into three distinctive categories to be implemented chronologically.

"Short-term" recommendations consist of the following:

- creation of a Mortgage Origination Commission to foster uniform minimum licensing qualification standards for mortgage industry participants;
- enhancement of the Federal Reserve's provision of liquidity, and access to lending through its discount window, to both depository and non-depository institutions; and
- expansion of the role of the President's Working Group on Financial Markets by adding the heads of the Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation and Office of Thrift Supervision to the current members from Treasury, Federal Reserve, Securities Exchange Commission and Commodities Future Trading Commission.

While Treasury views the insurance industry as a major component of the financial services industry, none of the short-term recommendations listed in the Blueprint are specific to the insurance industry. Moreover, while the Blueprint argues for a major overhaul of the insurance industry as a critical component of the broader

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financial services market, it fails to recommend the addition of an insurance representative to the President's Working Group, and it does not address access to discount window³ lending by non-depository institutions in the context of the insurance industry.

Treasury classifies its overhaul of the insurance regulatory framework as an "intermediate-term" goal, the most dramatic of which proposes an optional federal charter to be regulated by a new Office of National Insurance within Treasury. The Blueprint would also create the Office of Insurance Oversight that would have the authority to develop federal insurance regulations and positions on international regulatory issues, and coordinate the implementation of such regulations and positions with states and other countries. The Office of Insurance Oversight could be incorporated in the optional federal charter framework once insurance regulatory change is adopted by Congress. Other intermediate-term goals include:

- elimination of the Office of Thrift Supervision;
- determination of the appropriate federal supervisor of state-chartered banks;
- implementation of federal regulation of payment and settlement systems for the transfer of funds from financial institutions; and
- modernization of SEC regulation, followed by a merger of the CFTC and the SEC.

Henry M. Paulson, Jr., Secretary of the Treasury, concedes that implementing the intermediate-term recommendations, including the optional federal charter, could take between two to eight years.⁴ Overall, Treasury views an objectives-based, in contrast to a rules-based, approach as the best way to reach the long-term "optimal regulatory structure" for the financial markets.⁵ This approach would be implemented by the following four, newly-created regulators:

- Market stability regulator (the Federal Reserve) responsible for monitoring overall conditions of financial market stability that could impact the real economy, as well as collaborating with other regulators on rulemaking and taking corrective action when necessary in the interest of financial market stability.
- Prudential financial regulator responsible for the financial regulation of financial institutions, including establishing and monitoring capital adequacy, investment limits and other solvency related requirements.
- Business conduct regulator to handle consumer protection issues and standards for business practices across all types of financial institutions.
- Corporate finance regulator to assume the SEC's current authority regarding corporate oversight and accounting oversight.

Optional Federal Charter

The Blueprint advocates offering insurers the option to be regulated at the national level or under the current state system. Federal legislation would address the mechanics of obtaining a federal charter and licensing, regulation and supervision for federally chartered insurers, reinsurers and insurance producers.⁶

A newly created agency within the Treasury, the Office of National Insurance, would regulate federally chartered insurers. Insurers with federal charters would remain subject to "some continued compliance" with state laws, such as tax laws, compulsory workers' compensation, and individual auto insurance requirements, plus participation in residual risk mechanisms and guaranty funds. Rate regulation was intentionally excluded from those areas of regulation left to the states; as the Blueprint states "[w]hile numerous arguments have been made to justify such rate regulation, they are unpersuasive, especially since several states leave insurers largely free to set their own rates and Illinois does not have any rate regulation."⁷ While the Blueprint calls for federal regulation of solvency issues regarding, and for a comprehensive scheme for the receivership of,

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federally chartered insurers, it would require federally chartered insurers to participate in state guaranty funds as well.⁸

Finally, the Blueprint would establish a federal insurance institution (FII) charter for insurers offering "retail consumer products with some type of government guarantee." Such products would include property insurance, personal automobile, life insurance and even certain commercial insurance products sold to small businesses.⁹ While a FII charter would likely be "optional" (like the optional federal charter) for insurers, the Blueprint does not address the interplay between the FII charter and an optional federal charter.¹⁰

Insurance Information Act of 2008

On April 17, 2008, Representative Paul Kanjorski¹¹ introduced the Insurance Information Act of 2008¹², which would create a federal insurance oversight agency within the Treasury Department. Rep. Kanjorski's proposed legislation would create the Office of Insurance Information to collect and analyze data on insurance, advise the Treasury Secretary on major domestic and international policy issues, establish policy on international insurance matters, and coordinate the implementation of federal policy and international trade agreements with state regulators. The legislation is characterized as the first step toward the modernization of the U.S. insurance industry by building a source of knowledge and expertise regarding pressing domestic and international issues and developing a unified voice representing the U.S. insurance industry at the international level.

If passed, the Insurance Information Act of 2008 and the newly-created interim Office of Insurance Information would pave the way for the creation of the Office of Insurance Oversight as recommended by the Blueprint. The authority and role of the Office of Insurance Oversight would encompass and broaden those of the Office of Insurance Information. The Office of Insurance Oversight would preempt state laws or regulatory actions that are inconsistent with the international insurance policy established by the Office of Insurance Oversight. The Blueprint specifically refers to potential changes to reinsurance collateral requirements applicable to foreign reinsurers as an "international regulatory issue."¹³ The Office of Insurance Oversight would also advise Treasury on insurance issues that affect financial markets such as financial guaranty insurance, private mortgage insurance and natural catastrophe insurance.

State vs. Federal Debate

The debate regarding the need for a federal regulatory regime applicable to the insurance industry has been ongoing. Proponents of an optional federal charter argue that the federal government and its relevant agencies are better equipped to address competition, market accessibility and pricing issues than the fifty states' regulators combined. Opponents believe states' regulators have the necessary knowledge and expertise to face the challenges facing the insurance industry, and, in particular, protect the consumer.

The proponents of federal regulation contend that a unified system would level the playing field and allow insurance companies to compete with banks and securities firms by bringing new products to the markets in a timely manner and offering a wider variety of insurance products to consumers. Opponents argue that insurance products are specific to local markets and that state regulators are more accessible and more responsive to a crisis than the federal bureaucracy.

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The creation of an optional federal charter would not be the first time the federal government regulated some aspects of the insurance industry. The Liability Retention Risk Act of 1986¹⁴ created a new type of insurer, the "risk retention group," that could write insurance for its members in all fifty states while being subject to the laws of its charter state only. The Act preempted state laws that would hinder the formation and operations of risk retention groups in more than one state and any laws that would discriminate against a risk retention group or any of its members.

The Graham-Leach-Bliley Act¹⁵ (GLBA) was a further example of the federal government's encroachment into the states' regulation of insurance. The GLBA established which insurance products banks and their subsidiaries could provide. It allowed national bank subsidiaries to distribute all types of insurance, and it preempted state laws interfering with bank affiliations. It also directed federal banking agencies to supervise the sale of insurance products by banks. Furthermore, GLBA threatened to impose a federal licensing scheme for insurance agents and brokers under a new National Association of Registered Agents and Brokers (NARAB), unless at least 50% of the states enacted a uniform producer licensing law by November 2002. This was accomplished by the deadline, thus avoiding the establishment of NARAB; as of year-end 2007, at least 35 states had enacted some version of the NAIC Producer Licensing Model Act. Nevertheless, there was still a sense that state licensing procedures lacked uniformity, and thus, in March 2008, federal legislation was introduced to once again establish NARAB. However, unlike GLBA, the proposed legislation¹⁶ would make establishment of NARAB mandatory rather than conditional. NARAB would be created, regardless of further state efforts to create more uniform licensing procedures, as a private corporation (organized under the laws of the District of Columbia). Although producers would still need to obtain their resident licenses pursuant to the laws of their resident states, NARAB would license producers in all other states (i.e., NARAB would apply to nonresident producer licensing).

More recently, Congress passed the Terrorism Risk Insurance Act of 2002 to provide property and casualty insurers with a federal backstop program for catastrophic losses resulting from a terrorist act.¹⁷

Globalization of Insurance

The Blueprint goes beyond the traditional state versus federal debate about insurance and argues that the United States needs federal insurance regulation to allow its financial services markets to operate in a global economy. The insurance industry does not operate in a vacuum, but is part of the broader financial markets worldwide. The Blueprint argues that federal involvement is needed to provide a negotiating partner on the international stage and a policymaker on the domestic front. Regardless of one's views of the state versus federal debate, the Bush administration and some members of Congress note the international aspects of the insurance industry and the need to speak with one voice on issues such as collateral required from reinsurers domiciled outside the U.S. to allow for credit for reinsurance to the U.S. ceding company.

Arguably, state legislation regarding reinsurance and collateral requirements has an adverse impact on unauthorized foreign reinsurers. In April 2008, at the European Insurance Forum in Dublin, the issues of reinsurance collateral and the mutual recognition of regulatory systems between the U.S. and other countries were discussed.¹⁸ At the same time, the lead regulator in the United Kingdom and the Chairman of Lloyd's complained of the slow pace of regulatory reform in the United States¹⁹ and expressed frustration with the fragmented approach to insurance regulation in the biggest economy in the world. ²⁰ The NAIC, through its Reinsurance Task Force, has been addressing the issue of reinsurance collateral²¹, and, as of its meeting in March 2008, considered a proposal to regulate reinsurance based on three principles:

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- A "Reinsurance Supervision Review Department" (established as a division of the NAIC) would decide which non-U.S. jurisdictions are allowed to enter into a mutual recognition agreement;
- Non-U.S. reinsurers from approved jurisdictions would select a single, "port of entry" state to apply uniform minimum standards; and
- U.S. reinsurers would submit to the jurisdiction of a single state regulator, eliminating extra-territorial regulations by other state regulators.

Other countries have long recognized the impact of globalization on the insurance industry. In the European Union, the Member States have recognized this trend and have been working for the past decade at creating a common regulatory regime. Various directives have been passed to harmonize the member states on solvency, reinsurance, competition and distribution, as well as financial standards. The debate is not whether uniform regulation is needed, but the content of the directives. Member states understand that these issues need to be resolved at the supranational level.²²

Conclusion

The Treasury Department's Blueprint is an ambitious effort to steer the future regulation of the U.S. financial markets, including insurance. In addition to the optional federal insurance charter, the Blueprint contemplates an Office of Insurance Oversight to address international insurance issues. Representative Kanjorski's HR 5840 has introduced a similar entity- the Office of Insurance Information- to establish federal policy on international insurance matters and to ensure state insurance laws are consistent with federal policy. The creation of either office will send a strong message to the international community that the U.S. is intending to participate with other national insurance regulators to facilitate a consistent approach to insurance. Regardless of how the optional federal charter plays out, it would seem that all involved recognize that it is in the insurance industry's best interest to achieve a common approach for issues affecting the international arena.

It remains to be seen which, if any, of Treasury's ideas on insurance reform will be fleshed out and vigorously pursued, or if they will merely influence the ongoing political debate. Perhaps, the handling of international insurance issues will make it from "idea" to the finish line.

Endnotes

1. Kenneth R. Wylie, a partner with Sidley Austin LLP, acknowledges the assistance of Valerie Demaret-Fleming, an associate with Sidley Austin LLP, and Charlene C. McHugh, a counsel with Sidley Austin LLP, in the preparation of this article.
2. The Department of Treasury Blueprint for a Modernized Financial Regulatory Structure, Dept. of the Treasury (2008). <http://www.treas.gov/press/releases/reports/Blueprint.pdf>.
3. The Federal Reserve Discount Window is a program created in 1913 to provide, among other things, adequate liquidity in the banking system by allowing eligible institutions to borrow money at preferential rates on a short term basis. The official website is <http://www.frbdiscountwindow.org/index.cfm>

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4. Remarks by Secretary Henry M. Paulson, Jr. on Blueprint for Regulatory Reform (March 31, 2008), <https://www.ustreas.gov/press/releases/hp897.htm>.
5. Blueprint, at 137-138.
6. The National Association of Insurance Commissioners (NAIC) has voiced its opposition to an optional federal charter. NAIC Response to Treasury Report - Statement from NAIC President Sandy Praeger, March 31, 2008, http://www.naic.org/Releases/2008_docs/praeger_response_treasury_report.htm. Also see testimony of Eric Dinallo, New York Superintendent of Insurance, for a substantive defense of state regulation: Examining Proposals on Insurance Regulatory Reform, April 16, 2008 Hearing before the Subcomm. on Capital Mkts, Ins., and Gov't Sponsored Enter. of the House Comm. on Fin. Serv., 110th Congress (2008) http://www.house.gov/apps/list/hearing/financialsvcs_dem/ht041608.shtml.
7. Blueprint, at 129
8. Blueprint, at 130
9. Blueprint, at 167
10. *Id.* at 166. Products issued by FIIs would either remain covered by state guaranty funds or a newly-created federal insurance guaranty fund (FIGC) that would impose limits upon the amount of coverage recoverable by policyholders in the event of an FII's insolvency. If a FIGC is established, the FDIC would be reconstituted as the Federal Guarantee Corporation to oversee not only the deposit insurance fund, but also the FIGC.
11. Democrat - Pennsylvania and Chairman of the House Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises.
12. H.R. 5840, 110th Congress (2008).
13. Blueprint, at 11
14. The Liability Risk Retention Act of 1986, Pub.L. No. 99-563, 100 Stat. 3177 (1986).
15. Gramm-Leach-Bliley Financial Services Modernization Act, Pub. L. No. 106-102, 113 Stat. 1338 (Nov.12, 1999).
16. National Association of Registered Agents and Brokers Act, H.R. 5611, 110th Congress (2008).
17. Pub. L. No. 107-297 (Nov. 26, 2002) extended by The Terrorism Risk Insurance Extension Act of 2005, Pub. L. No. 10109-144 (Jan. 4, 2005) and The TRIA Reauthorization Act of 2007, Pub. L. No. 110-160 (Dec. 26, 2007).
18. M. Bradford, U.S. Treasury Moves to Reform Collateral Rules Welcomed, Business Insurance Europe, p.4, April 21, 2008.
19. International Developments in Insurance Regulation - Speech by Hector Sants, Chief Executive, FSA (April 8, 2008), available at http://www.fsa.gov.uk/pages/Library/communication/Speeches/2008/0408_hs.shtml.

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20. Lloyd's Chairman, Peter Levene quoted a previously used definition of the NAIC, "No Action Is Contemplated." Chief UK Regulator attacks U.S. Collateral Rules, Best Wire Services (April 9, 2008).
21. Reinsurance Proposal Makes Progress, Provides Roadmap for Responding to Change in Marketplace, NAIC Press Release (Nov. 16, 2007), available at http://www.naic.org/Releases/2007_docs/reinsurance_proposal_progress.htm
22. As a further example, the International Association of Insurance Supervisors (IAIS) represents insurance regulators and supervisors from around the world. The IAIS works with other international organizations, including the European Union, to promote global financial stability, to address the issues that the insurance industry faces worldwide and to set best practices and standards for the insurance industry.
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REFORMING THE TEXAS WINDSTORM INSURANCE ASSOCIATION

The Politics and Policy of Catastrophe Risk Sharing

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Hurricanes periodically savage the Texas Gulf Coast. Two storms in the late 19th Century damaged the bustling port city of Indianola so severely that it was never rebuilt. A beneficiary of Indianola's demise, Galveston, was itself flattened in 1900 in the most vicious hurricane ever recorded in the state; 8,000 people died. Another massive storm, Carla, killed 43 people and caused approximately \$2 billion in property damage¹ when it roared ashore near Galveston in August of 1961. Hail storms, tornadoes, and floods subject other parts of the state to catastrophe. Indeed, Texas insurers often complain that "cat losses" from these sources are worse because they are more frequent. However, only hurricanes have caused levels of devastation that demanded action by the Legislature.²

The State of Texas is searching for ways to deal with the aftermath of a catastrophic storm in the future. It does have a mechanism in place. The Texas Catastrophe Property Insurance Association (or "Cat Pool," as it came to be known) was created by the Texas Legislature in 1971 in response to Hurricane Celia, which caused substantial damage to coastal areas near Corpus Christi in 1970. The Cat Pool was renamed the Texas Windstorm Insurance Association (or "TWIA") in 1997. While TWIA has generally functioned well for the past thirty-seven years, it has become increasingly clear that the entity must be substantially changed if it is to protect Texans from the financial consequences of a major storm in the future. This article focuses on the options available to effect such change.

How TWIA Works Now

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TWIA operates under authority of Chapter 2210 of the Texas Insurance Code. It is basically a pool that most observers agree was intended to serve as an "insurer of last resort" for individuals needing property insurance in fourteen counties (and small portions of a fifteenth) along the 367-mile Texas Gulf Coast. Basically, all insurers that write property insurance in Texas are automatically members of TWIA; each faces the prospect of being assessed for TWIA's excess losses on a pro rata basis according to its market share in the state.³ By far the largest share of TWIA premium in force is found in Galveston County, at 30%, with Nueces County (home of Corpus Christi) second at 20% and Brazoria County third with 17%. Properties insured by TWIA must meet fairly stringent building code requirements, which have been strengthened over the years and continue to be modified. The Texas Department of Insurance ("TDI") licenses building inspectors and engineers to certify new structures as compliant with its promulgated windstorm building codes.

The Problem

The big problem facing TWIA -- and by extension, the State of Texas generally -- is the Association's lack of reserves in proportion to the amount of its liability exposure. While it was intended to function as an insurer of last resort, some say TWIA has become a first-choice (or "only-choice") insurer for many residents of the Gulf Coast. This has occurred at least in part because of the State's reluctance to let TWIA raise its rates to levels that most observers would consider to be actuarially sound. As a result of these artificially depressed premium rates, and the withdrawal of a number of property and casualty insurers from the coastal market, TWIA has become the cheapest source of insurance for many coastal business and property owners. Currently, TWIA has roughly 218,000 policies in force with a total liability of approximately \$65 billion. It has "reserves" of only \$1.4 billion.⁴

So what would happen if a killer storm were to wipe out the Houston Ship Channel and the communities around it? Or, worse, if such a hurricane were followed by another serious storm just a few weeks later?⁵ Experts estimate that such a catastrophe or catastrophes could cause as much as \$10 billion in property damage. In response TWIA would fund claim payments as follows: (1) through premiums collected on policies in force; (2) through a \$100 million "first-level" assessment against industry members; (3) through TWIA's Catastrophe Trust Reserve Fund, which currently holds \$389 million, and reinsurance (currently \$1 billion, with a retention of \$500 million)⁶; (4) through a \$200 million "second-level" assessment to industry; and, finally, (5) through "third-level" *unlimited* assessments to industry.⁷ It is possible that some insurers would be unable to pay such unlimited assessments. Their insolvency would in turn put increased pressure on the remaining carriers, some of which might also go broke. Those who could fund both their own claim payments and their share of TWIA's "unlimited" assessments in the short term would be entitled to take offsets against their premium tax liability for all such assessments paid to TWIA. Some industry observers peg the potential loss to the state's general revenue at hundreds of millions of dollars per year.⁸

Possible Solutions

The prospect of such a substantial hit to tax revenue is a sobering one for Texas legislators. The State's 81st Legislature, scheduled to convene in January of 2009, will therefore be casting about for possible solutions to the "TWIA Problem." One of the alternatives that has been discussed in the past is creation of a Texas windstorm reinsurance facility. Another alternative, which has already won the support of many legislators, is authorization for TWIA to issue public securities. Indeed Representative John Smithee introduced a bill, HB 2960, in the 80th Legislature that would have allowed TWIA to issue both pre- and post-catastrophe bonds to fund TWIA claim payments in the aftermath of a major storm. The fees for servicing such bonds would have been charged to insurers, who would in turn have been authorized to recoup them from surcharges on insureds statewide. The bill also proposed to "shrink" TWIA by eliminating caps on its premium rate increases; allow TWIA to charge different rates in different areas of the "windstorm" zone; change the composition of TWIA's board of directors; charge TDI with creating incentives for carriers to write business on the Gulf Coast; and require TWIA to keep its premium rates at a level that could be actuarially justified, including the cost of

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servicing any catastrophe bonds issued. The measure failed in the waning moments of the 2007 Legislative session, reputedly due at least in part to the efforts of coastal legislators who did not want to allow TWIA rates to increase rapidly. But Representative Smithee's bill, or some variant of it, will almost certainly be revived in the future.⁹

Another alternative that was floated recently by TDI involves the authorized imposition of insurer "surcharges." In March of this year, the agency posted two conceptual plans for dealing with the uncertainty of future TWIA assessments. The first of these is the "Assessment Recoupment Plan." While not committing itself to the position, TDI asked for comments on the feasibility of a rule that would allow insurers to seek quicker recoupment of their TWIA assessment payments through direct surcharges on their insureds, either in lieu of or in combination with premium tax offsets.

TDI's other plan would allow insurers to fund assessment amounts in advance by means of what it calls a "supplemental windstorm stabilization fee or surcharge" (i.e., additional premium) imposed on policyholders. Eligible insurers would be allowed to fund trust reserve accounts with surcharges collected from insureds in coastal areas, with the funds being released to the insurer, and presumably then returned to the *insured*, after five years. In some ways this is a mirror image of the Assessment Recoupment plan, except that the charges would be made *prior* to the assessment rather than after it and would be given back to the insured if no claim event occurred requiring its use.

Insurers and trade groups have raised numerous objections to the two surcharge plans proposed by TDI. For example, TDI has left open the question of how insurers would be allowed to apply the surcharge, even calling for comments on the *geographical* application of such charges, at least with regard to the "assessment recoupment plan." Should an inland policyholder be required to pay a surcharge on his homeowner's policy in order to pay for catastrophe claims incurred by insureds on the Texas coast? Florida policyholders are already experiencing these surcharges, with the potential of more to come, but at least in Florida virtually all property-owners have some exposure to hurricanes. In Texas, portions of the state are 600 miles from the coast.

Traditionally, TDI has discouraged discrimination in premiums among insureds of the same "class" or risk profile. The basic rule is that a difference in premium between two insureds of the same class is "discrimination."¹⁰ What is being proposed, however, could lead to two insureds being made subject to the same surcharge regardless of the fact that they have vastly *different* risk profiles (one lives in Galveston, for example, while the other one lives in the arid, mountainous region around Marfa). This is obviously not "discrimination"; it is arguably an objectionable *lack* of discrimination. Insurance is all about classification. Addressing the future of TWIA presents a classic problem in figuring out how and to what extent the financial contributions of the many should be applied to cover the risks of the relatively few. The problem is exacerbated in Texas because homeowners' insurance premium rates are frequently a political issue, especially in election years, and because Texas is historically a low-tax state.

In one sense, what TDI is proposing is a transfer of public responsibilities to private insurers. In effect, insurers would be imposing a state-approved "tax" on policyholders designed to make up for the inability of TWIA to reserve against the risk of future catastrophe in a particular region of the state.¹¹ Would an insured have any right to judicial relief for this type of "reverse discrimination," i.e., being subject to a surcharge meant to address a risk inapplicable to his or her property? There is no such cause of action in Texas or anywhere else of which we are aware.¹² The point is simply that the State, instead of acting directly to offer windstorm insurance in certain areas (as the federal government offers flood insurance, for example), or, at the other extreme, declining to regulate the property insurance market on the Gulf Coast at all, would in this circumstance be using private entities to effect a public policy goal -- namely, keeping insurance rates affordable on the Gulf Coast while at the same time protecting the State's coffers from hits to general revenue. While the State and coastal homeowners would benefit from this *de facto* subsidization, which is

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also a feature of legislative catastrophe bond proposals, it is unclear whether property-owners elsewhere in Texas will see any advantage to them in such a plan.

Increased development on the Gulf Coast means more jobs for Texans and increased tax revenue for the State of Texas. But it also means that the costs associated with the next big hurricane will be higher than ever. Obviously, someone is going to have to pay for the damage. Some insurers claim that a more rational approach than surcharge and bond issuance proposals would simply be to deregulate premiums in coastal areas and let private carriers collect premiums sufficient to fund adequate reserves -- without the unwieldy apparatus of, say, TDI's proposed "temporary" surcharges. TWIA could continue to function, but now as a true insurer of last resort, along the lines of the Texas Health Insurance Risk Pool, with eligibility predicated on rejection from at least one private market insurer.¹³ The Legislature could also impose a sales tax on tourism-related businesses (hotels and restaurants, for example) along the Gulf Coast to create a fund capable of funding disaster-related repairs for those who are priced out of the insurance market--as some individuals and businesses surely would be, at least in the short term.

But *rational* does not always mean *feasible*. Texas homeowners' insurance rates are already a hot-button political issue. Given the political problems that would arise as a result of a dramatic hike in windstorm coverage for Gulf Coast residents -- an increasing segment of the state's population -- it's unlikely that any radical free market measures will be taken in the near future. The goal for the Texas Legislature in 2009 will be to make property-owners along the Gulf Coast pay more, but not *too much more*, for their coverage -- and probably to spread the risk of coastal losses to other policyholders in the state in a way that does not spark major political resistance. Only time will tell whether Marfa homeowners will willingly pay surcharges for the protection of Corpus Christi condominiums.¹⁴ As another storm season approaches, such issues will move to the fore again.

Endnotes

1. Measured in 2005 dollars.
2. Some meteorologists believe that hurricanes are becoming stronger and more frequent due to global warming. See, for example, "Warmer Oceans, Stronger Hurricanes," by Kevin E. Trenbarth, *Scientific American*, July 2007, p. 44. Even if they are not, however, the size and density of development on the Gulf Coast is exponentially greater now than it was in 1900 or even 1960. As a result, when another killer storm makes landfall--as another storm will, sooner or later--the magnitude of destruction will necessarily be far greater.
3. Insurers can offset their potential liability by voluntarily writing property insurance in the TWIA-covered counties. Tex. Ins. Code Ann. §2210.052(d) (West 2008).
4. Terence Stutz, "Texas' Coastal Weather Affects Insurance Rates Statewide," *Dallas Morning News*, March 18, 2008. As recently as 1993, TWIA's total liability exposure was only \$6.5 billion, one tenth of what it is now. Senate Research Center Bill Analysis, H.B. 2960, May 14, 2007.
5. Hurricane Rita followed Hurricane Katrina by only a few weeks in the summer of 2005.
6. This is thought to be one of the largest reinsurance contracts in the world. Reinsurance is and will likely remain an important part of TWIA's claims payment strategy. Indeed, Commissioner of Insurance Mike

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Geeslin recently authorized TWIA to increase its reinsurance purchase for the 2008 storm season to \$1.5 billion over a retention of \$600 million, significantly strengthening TWIA's claims-paying ability. Disclosure: The authors of this article represent the Reinsurance Association of America (the "RAA"). The opinions expressed are their own, not those of the RAA.

7. Tex. Ins. Code Ann. §2210.052(d) (West 2008).

8. See, for example, Beaman Floyd, "Ensure Protections for Texas," *Austin American-Statesman*, June 29, 2007. Floyd evidently extrapolates from a 2005 figure for total Texas property and casualty insurance premium tax payments of \$472 million. A big enough assessment could result in property insurers offsetting against all premium taxes owed to the State for a period of years that is not limited under the current law.

9. South Carolina enacted a wind pool "reform" statute in 2007 that was similar in aim if not in proposed methodology. Its Omnibus Coastal Property Insurance Reform Act of 2007 contained insurance company incentives for providing coverage within the state's "wind pool" territory, codified an earlier expansion of the pool, and created a requirement that insurers give 90 days' notice before nonrenewing in the wind pool territory during hurricane season. The law also created tax incentives for consumers who set up "catastrophe savings accounts."

10. Tex. Ins. Code Ann. Sec. 544.052 (West 2008); *Cortez v. Progressive County Mutual Insurance Company*, 61 S.W.3d 68 (Tex.App.-Austin 2001, pet. granted, judgment vacated pursuant to settlement).

11. Purchasers of Texas automobile insurance policies already must pay a mandatory Automobile Theft Prevention Authority fee of \$1.00 per vehicle per year, which goes to recoup insurers for the \$1.00 per year they must pay to fund Texas's Automobile Theft Prevention Fund. 28 Tex. Admin. Code §5.205. While all insureds pay this amount regardless of whether they operate their own vehicles in a high-theft area, it's likely the small amount of the charge has muted any possible political controversy.

12. The most analogous case we have found in this regard is *State v. Bigham*, 575 A.2d 868 (N. J. 1990). In *Bigham*, the plaintiff sued the State of New Jersey because it applied a surcharge to her after she was ticketed for driving with an expired license. The surcharge was imposed as part of a statutory scheme to use surcharges for various driving offenses to fund the State's Full Insurance Underwriting Association (the "JUA"), a last-resort insurer of high-risk drivers. Bigham argued that the surcharges were meant to apply only to driving offenses that threatened *public safety*, since the intent of the statute that created them was to use surcharges on "bad drivers" to fund the JUA; in other words, she was being lumped into a risk classification to which she felt she did not and ought not to belong. The Court rejected the argument, though one dissenting justice did point out that the actuarial considerations underlying the statute supported Bigham's argument.

13. See Tex. Ins. Code Ann. §1506.152 (West 2008).

14. To be fair, advocates for coastal residents argue that their premiums subsidize hail and tornado losses incurred by other Texans during non-hurricane years. Insurance necessarily involves some policyholders subsidizing others; the question is, of course, how much "subsidizing" is either legally or politically viable?