NATIONAL CONFERENCE OF INSURANCE LEGISLATORS
FINANCIAL SERVICES & INVESTMENT PRODUCTS COMMITTEE
POINT CLEAR, ALABAMA
NOVEMBER 17, 2012
MINUTES

The National Conference of Insurance Legislators (NCOIL) Financial Services & Investment Products Committee met at The Grand Hotel Marriott Resort in Point Clear, AL, on Saturday, November 17, 2012, at 8:00 a.m.

Sen. Ruth Teichman of Kansas, acting chair of the Committee, presided.

Other members of the Committee present were:

Rep. Barry Hyde, AR	Sen. Neil Breslin, NY
Sen. Travis Holdman, IN	Rep. Charles Curtiss, TN
Rep. George Keiser, ND	Rep. William Boztow, VT
Rep. Don Flanders, NH	Rep. Kathleen Keenan, VT
Sen. Carroll Leavell, NM	Del. Harry Keith White, WV

Other legislators present were:

Rep. Matt Lehman, IN	Sen. Peter Pirsch, NE
Sen. Ruth Teichman, KS	Sen. David O'Connell, ND
Rep. Ronald Crimm, KY	Sen. Bill Brown, OK

Also in attendance were:
Susan Nolan, Nolan Associates, NCOIL Executive Director
Candace Thorson, Nolan Associates, NCOIL Deputy Executive Director
Ed Stephenson, Nolan Associates, NCOIL Director of State-Federal Affairs – D.C.

MINUTES
After a motion made and seconded, the Committee voted unanimously to adopt the minutes of its July 13, 2012, meeting in Burlington, VT.

BOND INSURANCE MARKETPLACE AND MUNICIPALITIES
Bruce Stern of Assured Guaranty, representing the Association of Financial Guaranty Insurers (AFGI), gave an update on the current state of the municipal bond market, particularly the increasing stress on municipalities. He mentioned Jefferson County, Alabama, as a case that he and others in the industry hopes is an isolated one. He said that stress on municipalities often results from special projects, like the water treatment plant in Jefferson County or the incinerator project in Harrisburg, Pennsylvania, or stress can arise from outsized pension obligations, such as in Stockton, California.

Mr. Stern said that when municipalities that have sold insured bonds start having trouble meeting their payments, municipal bond insurers frequently seek to advise them and provide creative and effective solutions. He said that his organization is concerned, however, that outside law firms, financial advisors, and political interests now frequently intervene with the promise of Chapter 9 bankruptcy, and they sell it as a panacea that will cancel debts and "wipe the slate clean." He said that in his experience it does not work this way because in the few instances where municipalities have gone through bankruptcy, lawyers and financial advisors have gotten large fees without a satisfactory outcome for taxpayers or workers.

Mr. Stern said that a significant factor in whether an insurer will provide a guarantee, and in the cost of that guarantee, is the ability of a municipality to declare bankruptcy. He related that some states do not permit bankruptcy and others require supervision in any bankruptcy process. He said that at a minimum a municipality should be required to consult with state experts before making any decisions.

Mr. Stern said that the current situations are novel. He said that Stockton is the largest city ever to declare bankruptcy, and Jefferson County is the largest in terms of dollars. He said the industry is concerned that lawyers are treating the new bankruptcies like corporate reorganizations, trying to eliminate as many obligations to bond creditors as they can, which would trigger insurance claims for the payments.

Mr. Stern said many believe the insurers are from Wall Street and should pay the full freight. But, he noted, the insurers only take a small premium because the contract only covers the payments when they are due. He said the insurers certainly do not supply additional funding to projects when they are failing. He said that if you change the model for resolving a municipality's financial problems—trying to force the insurers to permanently assume the obligations when funding runs short—you will ultimately deprive municipalities of an important mechanism that saves billions of dollars in financing costs.

Rep. Keiser asked what the relationship was between Credit Default Swaps (CDS) and bond insurance. Mr. Stern explained that CDS are financial instruments usually written by a bank or other financial institution and that CDS are now regulated under Dodd-Frank. He added that CDS can be accelerated but financial guaranty insurance covers the payments as they are due. He added that financial guaranty insurance cannot be traded separately from the bond, while CDS can. Mr. Stern said that, since they are tradable and there is no interest in the bond required, CDS became a way for third parties to bet for or against an issuers' performance. He said that guaranty insurers believe that insurance is the better way to address the risk. He said that financial guaranty insurers did at one time insure CDS but they did so in a way that was similar to the way they guarantee a bond.

Sen. Leavell asked what effect the changes in accounting that require states to include pension funding shortfalls on their balance sheets will have on municipal financing. Mr. Stern responded that the rating agencies haven't integrated the pension assumptions into their analysis yet and he expects a lowering of ratings when they do. He continued that the willingness to pay becomes an issue as well because the rating agencies look for a plan to continue paying the bonds and become very concerned when there is talk about bankruptcy as a solution. Sen. Leavell said that the pension numbers are prompting some states to make such a plan. He said states are also changing the pension systems, often to a defined contribution approach.

Sen. Holdman said he is concerned that the Office of Comptroller of the Currency (OCC) is requiring banks to assess the financial health of municipalities they invest in on an ongoing basis. He said that municipalities often don't have the systems in place to provide reporting. He asked if there were any standards that could be used. Mr. Stern responded that the Securities and Exchange Commission (SEC) is staffing up their office that deals with municipal bonds and that he hopes that there will be more disclosure and accounting standards coming from them soon. He commented that transparency will help both the insurers and municipalities.

LENDER-PLACED INSURANCE

Kevin McKechnie of the American Bankers Insurance Association (ABIA) said that as of September, there were 1.4 million homes in foreclosure, which translates to 3.3 percent of mortgages. He said the year before the number was 1.5 million and that it is obvious the problems will not clear up soon. He said the rate of mortgages underwater is also a problem, with 61.2 percent in Nevada, 45 percent in Florida, 43 percent in Arizona, 37 percent in Georgia, and 35 percent in Michigan. He said of the states with the highest foreclosure rates, Florida has 11.5 percent of all mortgages in foreclosure, New Jersey has 7.3 percent, New York has 5.3 percent, Illinois has 5.2 percent, and Nevada has 4.9 percent. McKechnie said the discussion around forced-placed insurance takes place against this backdrop. The market is starting to recover, he said, but there is obviously a long way to go before it returns to normal.

Mr. McKechnie said a Dodd-Frank provision and regulations related to insurance coverage notice requirements have been generally agreed upon and are seen as reasonable. However, he said that his organization feels that a recent regulatory proposal by the Consumer Financial Protection Bureau (CFPB), Fannie/Freddie, and the Federal Housing Financing Administration (FHFA) is clearly beyond statutory authority. He explained that 49 states had settled a court case with the five largest mortgage servicers and that this settlement requires those large servicers to continue to pay for homeowner's hazard insurance even if there is no money left in the escrow account. However, he said, the CFPB incorporated this settlement requirement into its proposed requirements for all servicers, including small ones.

Mr. McKechnie felt this requirement would not be that significant an issue for the five largest servicers. His concern, he said, is that the other 1,200 or so are often small community banks. He said it could be a significant financial and compliance burden for those banks to fund escrow accounts for insurance policies to which they are not a party, and that may have been cancelled. Mr. McKechnie said his organization is also concerned with breach of contract issues. He said the ABIA has made comments in opposition to these proposals.

Mr. McKechnie also said that FHFA and Fannie/Freddie recently related that ideally they would like to replace forced-placed insurance with a blanket policy that would not require a broker and would not be part of a market. Mr. McKechnie said that unfortunately for them, there is no federal insurance framework that would make this possible. He expressed disappointment that the Federal Insurance Office (FIO) was not on hand to explain this to the banking agencies and said he hopes that in the adjustments to Dodd-Frank, better communication will be established.

Lastly, Mr. McKechnie pointed out that Sandy hit some of the states with the highest foreclosure rates and therefore the highest number of properties with forced-placed insurance. He said that forced-placed insurance is the highest risk category for homeowner's insurance because the insurer writes the policy with little information about the property or occupants. He said the banks are trying to get a handle on the capital needs of the insurers to rebuild the homes damaged by Sandy. He questioned the wisdom of New York's recent discussion of lowering the capital requirements for forced-placed insurance.

Rep. Keiser asked if the cost of forced-placed insurance is added to the amount due on the mortgage. Mr. McKechnie said yes, but the problem is that so many of these mortgages are underwater and the cost of the insurance becomes one more cost the bank has to absorb. He said the mortgagee unfortunately does not have the option to simply continue the homeowners' insurance.

FEDERAL ISSUES

Julie Gackenbach of Confrere Strategies gave a report on federal issues, starting with Dodd-Frank implementation. She said that 60 percent of the deadlines for writing regulations have been missed. She said this isn't surprising, as those deadlines were optimistic. She said it is not anticipated that the pace will quicken over the next year, given the complexity of the regulations, the cost/benefit analysis requirements, and the oversight the House is performing.

Ms. Gackenbach said the biggest issue for insurers is the release by U.S. banking regulators of regulations designed to re-align U.S. capital standards with those of Basel III. She said the proposal was upsetting because it would subject insurers with entities regulated as banks in their corporate structure to entirely bank-centric regulation. She said there was little recognition of the differences between insurance and banking as to capital structure, regulatory requirements, and accounting. She said the proposal did not, for instance, recognize NAIC statutory accounting. She said there have been comments that complain of a lack of due process in writing the rules and of the cost of compliance, with some respondents suggesting it could cost $100 million to set up dual reporting. She said the U.S. bank regulatory agencies have suspended the January 2013 effective date, which would have been a six month lead-time, but they haven't announced whether they are re-visiting the proposals or withdrawing them. Congress has joined in the criticism, she said.

In other Dodd-Frank-related news, Ms. Gackenbach related that the Office of Financial Research (OFR) continues its work on legal entity identifiers. She said a number of hearings related to Dodd-Frank implementation will be held in the lame duck session of Congress and that they will continue after the New Year.

Ms. Gackenbach said that the FIO is spending most of its time on international issues such as the EU-US Dialogue and the IAIS Common Framework for the Supervision of Internationally Active Insurance Groups. She gave the response to Sandy as an example of the FIO beginning to operate domestically. She said the FIO added questions to the NAIC's post-catastrophe data call in order to avoid having to make its own completely separate call. She said the FIO is also reaching out to other federal agencies to increase dialogue and describe the impact of proposed regulations on insurance.

Ms. Gackenbach told the Committee that the FIO report has not been released yet. She said word has it that the report is finished but that other issues are occupying senior people at Treasury, such as the fiscal cliff and issues with London Interbank Offered Rate (LIBOR) manipulation. Rep. Keiser said he has heard that the report is done, that it was not complimentary of the current state of insurance regulation, that it was held until after the Presidential election, and that it will not be released in the lame duck session. He asked if Ms. Gackenbach had any comment. She said she had heard much the same that the report will take an unflinching view of regulation. In terms of timing, she said that as a report to Congress, there is a process around it being presented and that the Congress is occupied during the end of the session. Sen. Leavell said that notwithstanding the recommendations that may be in the report, he has heard from Director McRaith that they have no intention of regulating insurance from the FIO.

2013 COMMITTEE CHARGES

Upon a motion made and seconded, the Committee unanimously adopted the proposed 2013 charges, as follows:

- continue to examine Dodd-Frank Act implementation/impacts (e.g., FIO, FSOC, CFPB, etc.)
- monitor state, federal lender-placed insurance issues
- continue to explore impacts of the financial crisis on the bond insurance market/municipalities

- monitor emerging insurance regulatory impacts of social media
- monitor state and federal pension reform initiatives

OTHER BUSINESS
As it was her last meeting, Sen. Teichman thanked the Committee and staff for their assistance.

ADJOURNMENT
There being no further business, the meeting adjourned at 4:45 p.m.