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Helping Hands

Reinsurance and LTC have a long history together—expect their relationship to last

By Matt Morton, FSA, MAAA

Long-term care (LTC) insurance and reinsurance are connected in a variety of ways. Over the past few years, the LTC market has seen:

- Wilton Reassurance Company assume $2.7 billion of LTC liabilities from CNO Financial Group. In addition to the $2.7 billion liability transfer, CNO Financial Group contributed an additional $825 million to Wilton for taking on the risk.
- GE announce a plan (in January 2018) to contribute $15 billion of capital over seven years to support the LTC liabilities of GE Capital's two insurance entities: Employers Reassurance Company (ERC) and Union Fidelity Life Insurance Company (UFLIC). All LTC liabilities in ERC and UFLIC are reinsured from direct writers.
- Hannover Reassurance Company announce a reinsurance partnership with OneAmerica on life/LTC hybrid products. Hannover began sharing the actuarial risks with OneAmerica on its hybrid product, called "Asset Care," on January 1, 2018.

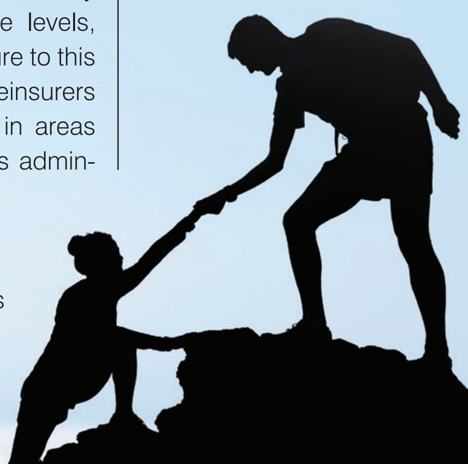
Reinsurance provides a variety of solutions for direct carriers, but it also presents additional risks such as reputation and counterparty risks. Capital requirements for LTC are significant, and reinsurance may alleviate that pressure. Investors in companies with LTC portfolios are very hesitant to trust current reserve levels, and reinsurance reduces exposure to this risk. Lastly, on new products, reinsurers can provide valuable expertise in areas such as underwriting and claims administration.

Historical Drivers

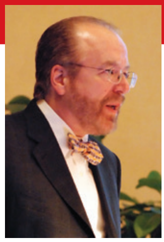
Historically, the LTC industry has utilized reinsurance for multiple reasons. Insurers used reinsurance to gain entry into the LTC market, because reinsurers were able to take a longer view of the risk and reward of this product as opposed to direct writers. Capital relief provided to direct writers also aided them in developing the product and in sales growth.

Reinsurance opportunities have evolved over time. Today, new entrants into the market have benefited from improved data collection and assumption development methods. Using data-driven approaches to develop the assumptions underlying LTC products has proven to be more successful in predicting the future of these policies than earlier models were. Reinsurers have observed that the nature of this product (low frequency

["Helping Hands" continues on page 28]



IN THIS ISSUE



Resolving Legacy Long-Term Care Insurance Blocks: Is There a "Better Mousetrap"?

(This is the first installment of a two-part column)

As NAIC President Eric Cioppa said at the July 2019 NOLHGA Legal Seminar (reported elsewhere in this issue), the NAIC has made its top priority for 2019 addressing some important challenges concerning long-term care insurance (LTCi). At the NAIC's Summer National Meeting in New York early in August, Virginia Commissioner Scott White chaired the first meeting of the recently formed Long-Term Care Insurance (EX) Task Force (Commissioner White and his Vice Chair, Colorado Commissioner Mike Conway, were also Legal Seminar presenters). At the New York meeting, Commissioner White reported to a large audience on the six workstreams that the task force is pursuing.

The difficult challenges posed by "legacy" blocks of LTCi business—and particularly the pressures that they have placed on insurer solvency, the risks they have raised for the solvency of several carriers, and the concerns for insurance consumers—have drawn considerable attention among the general public, the trade and financial press, rating agencies, and elsewhere.[1]

While it is fortunately true that most legacy LTCi liabilities reside in healthy, diversified insurance companies unlikely ever to face receivership, several carriers concentrated their business to a great extent in LTCi business; those carriers have raised the most serious concerns.

The NAIC Process. The NAIC should be commended for its commitment to address, through the new task force, significant LTCi issues, including issues of consistency and equity in premium adjustment applications; supporting new product development to meet future consumer needs; insurance liability reserve valuation; and regulatory data needs.

Of particular interest to *NOLHGA Journal* readers, one workstream of the task force was reported to be "…(R)estructuring techniques, and whether there are alternatives for protecting policyholders from guaranty fund caps…".[2]

Concerns over legacy blocks of LTCi business have been extraordinarily painful for all stakeholders, and never more so than in cases of insurers facing insolvency. Inevitably, that pain is shared by stakeholders: Most importantly, by policyholders; but also by investors in the failed company; regulators charged with protecting policyholders; and those who must pay the costs of protecting consumers when an LTCi writer is liquidated and guaranty association (GA) "safety net" protections are triggered (including GA member insurers, their policyholders, and taxpayers).

A Better Mousetrap? The infliction of all that distress on all stakeholders has prompted many to ask in good faith whether a different approach to resolving a failed LTCi carrier could improve outcomes for some or all stakeholders, compared to outcomes produced by liquidation. The question, in effect, is whether there is a "better mousetrap" that might be employed in LTCi resolutions.

If outcomes indeed could be improved through a different approach, most of us would enthusiastically endorse that result. But it is also necessary, in considering that question, to focus seriously on those challenges that must be met in any LTCi carrier resolution; how those challenges are addressed by the *current* regulatory/receivership/GA processes; and how those challenges might be addressed through any alternative strategies.

We will attempt (in this installment of a two-part series) to examine, first, those challenges that must be met in any resolution of an LTCi carrier. In the second installment, we will examine how stakeholders joined forces to address those resolution challenges in the recent Penn Treaty[3] case, and we will explore some considerations for whether a "new mousetrap" might work as well.

GA Protections for LTCi Policyholders

As a preliminary matter, media accounts of the NAIC Task Force's restructuring workstream present a misleading notion: In fact, GA protection is an essential policyholder *benefit* in an insurance carrier's resolution, and not something from which policyholders require "protection." Let's review the bidding to see why that is so.

Until all states had (by 1991) adopted laws creating life and health insurance GAs to protect state residents, policyholders in states without GAs had *no* "safety net" protection for their investments in policies issued by a failed insurer. Their only

hope for recovery was from the claims that they could assert, as creditors, against assets of that insurer.[4] In the absence of GA protections, policyholders were left entirely unprotected against both the ability of the insurer's "estate" to marshal assets in amounts sufficient to pay policy claims, and also against delay in receiving whatever partial payments they might receive on their claims. Stated differently, policyholders were entirely exposed to both a "credit" risk (the amount of payment from assets) and a "timing" risk (delay in any such payments).

The creation of GAs significantly mitigated both those credit and timing risks by requiring the GA of a policyholder's state of residence to become responsible to the policyholder immediately upon liquidation for payment of claims as claims became ripe, and for guaranteeing contractual values reflected in the policyholder's account.

Like virtually all financial safety net mechanisms, GA coverage is not limitless (Cf. FDIC, PBGC, and insurance "policyholder protection schemes" around the world). Nonetheless, the amounts of policyholder benefits specified in the NAIC Life and Health Insurance Guaranty Association Model Act (Model Act), as the Model Act has been enacted by the individual states, are substantial. The Model Act calls for GA protection of the first $300,000 of LTCi benefits, and the GA laws of all states are now at least at that level of protection. (Legislatures of several states have opted to provide even more protection, and one state's GA provides coverage of all LTCi claim expenses without limitation as to amount.)[5] Actuaries for NOLHGA's Penn Treaty Task Force estimate that at least 90% of Penn Treaty policyholders will be *entirely* protected by GA coverage: That is, for at least 9 of every 10 Penn Treaty policyholders, the entirety of their claims are projected to fall within GA protection levels and are expected to be paid in full.

In addition, for all life and health insolvencies of which NOLHGA is aware, dating back to the 1980s and before, policyholders with claims *exceeding* GA coverage levels have been able to assert priority claims (ranking *pro rata* with the subrogation claims of GAs who provide policyholder benefits for covered portions of claims) against assets of their insurer's estate for portions of insurance policy claims *not* covered by GAs. In other words, in all those cases, if an insolvent company had assets sufficient to cover, e.g., 70% of policy-level claims, a policyholder with a claim exceeding GA protection levels would be entitled to receive 70 cents on the dollar from the estate for the *uncovered* portion of her claim, *in addition to* GA protection for 100% of the claim that her GA would cover. Historically, that excess coverage has been very important to policyholders.[6] Because policyholders historically have been protected by the combination of GA coverage and estate asset distributions for such excess claims, GA protection is more accurately understood as a "floor" of protection, not a "cap."[7]

To be sure, maximizing the overall recoveries of policyholders in the insolvency of an LTCi insurer is—and should be—the goal of all LTCi resolutions. But the first essential problem to be solved, as we will see, is the inherent inadequacy of available funding sources to pay claims, and *not* the fact that GA protection has an upper limit. That problem—the inadequacy of funding, which is the essence of an insurer insolvency—inescapably confronts both resolutions under the existing framework and any plan for a "better mousetrap."

["President's Column" continues on page 29]

Welcome to the Revolutions

From healthcare to long-term care to the regulatory arena to cybersecurity, change was in the air at NOLHGA's 2019 Legal Seminar

By Sean M. McKenna

Attendees of NOLHGA's 2019 Legal Seminar, which was held on July 11–12 in Boston, learned a few things—that Boston in July can get a mite muggy; that some hotels employ dogs; that the Red Sox don't stand a chance of making the playoffs (according to the locals); and that *Big Trouble in Little China* is the greatest movie ever made (according to all those whose opinions matter).

The 200+ attendees also learned that Boston, birthplace of the American Revolution, was the perfect setting for the Seminar. Because on just about every topic—healthcare, long-term care (LTC), insurance regulation and legislation, cybersecurity,

etc.—there's a whiff of revolution in the air. Things are changing, to the point where some speakers were checking their phones as they walked to the stage to make sure the information they brought with them was still accurate. And in the midst of revolution, the Legal Seminar was the perfect place to gain insight into where all this change was heading, and how to (if possible) get ahead of it.

Alphabet Soup

The Seminar featured three discussions on insurance regulation, and after a few hours discussing the ACA, ICS, IAIS, IBTs, SIFIs, and more, it's a wonder some attendees didn't go AWOL.

The first panel, *Financial Supervision: State, Federal & International Developments* (moderated by Pat Hughes of Faegre Baker Daniels LLP), discussed the impact those three tiers of regulation have on U.S. insurers and how state and federal regulators coordinate their efforts, both domestically and on the international scene. That coordination "may have been a little rocky early on," said Tom Sullivan (Federal Reserve), "but the voice of the U.S. has never been better represented than it is now." Ann Kappler (Prudential Financial), agreed. "We've come a very long way," she said, before cautioning, "I wouldn't say we're perfect."

Turning to international regulation and standard-setting, Sullivan said that "we in the Fed believe in the utility of international standards—they're good for the financial markets." He also stressed that U.S. regulators—Team USA—have to be engaged as standards are developed. Kappler noted that these standards affect the U.S. market, even if U.S. regulators don't adopt them, because many companies do business worldwide. Christine Neighbors (Ameritas) said the effect reaches past the multinationals. "There have already been changes to our system due to international regulation," she said. "I call it 'spill down.' These effects are going to come down to the midsize market in some way."

The one standard on everyone's minds was the Insurance Capital Standard (ICS). Sullivan admitted that "I still have a lot of skepticism about the ICS." Kappler added that "unless there are substantial changes, it will be a standard that punishes long-term products." She also noted that European countries, which have more substantial social safety net programs than the United States, don't use some of these products.

All three panelists had high praise for the move toward activities-based (rather than entity-based) regulation. "Our view is that it should have been activities-based all along," Kappler said. Neighbors (like Sullivan, a former state regulator) agreed, saying "we should have been looking at activities

Massachusetts Insurance Commissioner Gary Anderson welcomed attendees to Boston and spoke about his department's emphasis on working with the guaranty system and others when dealing with company resolutions. "The value of retaining experienced professionals early in the process cannot be overstated," he said.

Luncheon speaker Sara Martin (Massachusetts Historical Society) entertained attendees with a presentation about John Quincy Adams and his parents, John and Abigail Adams. "The Adamses had this uncanny ability to be in the right place at the right time" throughout the early history of the United States, she said, from the Revolutionary War to the White House to Congress. The family also placed a premium on writing (John Quincy Adams kept a diary for almost 68 years) and preserving what they wrote, much to the delight of historians.

all along." Sullivan raised a note of caution: "We need to keep our eyes open—neither approach is a panacea." He also reminded the audience that the actions of one company can affect the entire financial system: "The fact that it did happen in the past should give everyone pause."

The second regulation panel, *Health Insurance Developments & Challenges* (moderated by NOLHGA Chair Susan Voss (American Enterprise Group)), was given the seemingly simple task of coming up with a panacea for the U.S. healthcare and health insurance markets. The 45-minute time limit did them no favors.

Asked to identify the key issues in the healthcare market, Pennsylvania Insurance Commissioner Jessica Altman said that "the issue that keeps me up at night is healthcare costs and the unsustainable growth of those costs." The good news, she added, is that whereas the Affordable Care Act (ACA) focused primarily on accessibility, "we're really focusing on costs now." Keith Passwater (KTPassCo) noted that "instant bankruptcy [from healthcare costs] has waned somewhat, but these costs are really a great drain on our economy."

Some have suggested that providing information on costs directly to consumers will help bring costs down, but the panelists expressed some skepticism. For one thing, cost is only half the equation. "We have plenty of information on costs," said Greg Martino (Aetna), "but it gets really dangerous when you start rating quality." Altman added that only about 20% of healthcare is "shoppable"; for the rest, consumers have little choice, or the need for quality trumps price. Passwater noted that research on "nudges" to increase wellness indicates that such programs are effective, but "that's a very long-term play." Martino, who said that "your zip code has more to do with your health than your DNA," also stressed the value of programs that work with communities to enhance wellness.

The panelists also addressed the growing consolidation in the healthcare market. "We're really seeing dynamic change," Martino said, as hospitals partner with doctors or with insurance companies. He noted that privacy will be a big issue going forward.

"Pennsylvania is at the forefront of this," Altman said, with its three largest insurers partnered with hospitals. "It can really change the competitive dynamic." This type of consolidation is putting a strain on regulators, since these partnerships are unlike traditional mergers—the emphasis is more on integration than acquisition. "Integration is power, for good or ill," she added. "There's a lot of opportunity and promise to be had," but regulators have to be sure that this promise pays off for consumers.

In closing, the panelists were asked to predict what would happen if the ACA fails. Altman said that it would "wreak havoc" on the markets—the individual insurance market is so dependent on federal spending, she added, that it might disappear. "The federal government doesn't have a backup plan if the ACA fails," she said. "We're at the point where we need to stop trying to undermine it and let it work."

Passwater explained that since most consumers on the insurance exchanges receive subsidies, "that pool would become a high-risk pool overnight." He also warned that, at some point, people receiving treatment wouldn't be able to pay for it anymore. "Politically, there could be an enormous backlash." Martino said that insurers are already suffering from the lack of a consistent regulatory environment. The fall of the ACA would disrupt things for everyone. "We're swinging right, we're swinging left. It's hard for consumers and insurers."

A changing environment—legislative rather than regulatory—was the focus of the third panel, *Developing Legal Framework for Corporate Division & Insurance Business Transfers* (moderated by Franklin O'Loughlin of Lewis Roca Rothgerber Christie LLP, but somehow not referred to by everyone as The O'Loughlin Group). The panelists addressed laws, passed in a few states, that allow insurers to either split into two or more companies (corporate division) or transfer books of business to a new company (insurance business transfers, or IBTs). Neither action requires the consent of the policyholders.

"The NAIC is very concerned with IBTs and corporate division plans," said Superintendent Beth Dwyer (Rhode Island Department of Business Regulation). A working group has been formed to gather information on the various statutes and to explore similar laws in other countries, such as the UK's Part VII Transfers. "What we haven't heard a lot of is how these transactions are beneficial to consumers." She added that concerns have been expressed about LTC companies using these laws to shed old policies.

James Mills (Enstar Group) provided an overview of how these transactions work in other countries and why they're attractive to companies seeking to focus on their core businesses, exit low-performing markets, or transfer loss reserves for capital relief. Walking attendees through a series of Part VII transfers through which Enstar acquired blocks of business from seven companies, he demonstrated how the transfers allowed Enstar to achieve operational cost savings and consolidated regulatory supervision.

Birny Birnbaum (Center for Economic Justice) acknowledged that "a case can be made for these tools for certain situations" but sounded the alarm that "there's no requirement for policyholder approval." He also expressed concern that the new company, which is simply administering the policies, has no interest in keeping customers satisfied—unlike a traditional insurer that wishes to keep its customers happy. "We have real concerns for what these transactions would encourage as far as company behavior."

Birnbaum suggested that the laws include funding for a "policyholder advocate" to represent the interests of policyholders affected by the transaction. Dwyer said that the NAIC working group is still gathering data and will address the concept of a policyholder advocate, as well as concerns about the quality of the assets in the new company.

O'Loughlin removed his moderator hat for a moment to point out that under the Illinois IBT law, the original company does not maintain liability for the policies placed in the new company, and the new company is only required to be licensed in Illinois. If that company failed, he explained, "the Illinois guaranty association may be exposed to cover non-Illinois residents." This could strain the association's assessment capacity if the company had policyholders in a large number of states.

Dark Clouds

The Seminar also featured two panels on LTC—one on the use of reinsurance and the other on developments in the LTC market. In *Reinsurance/LTCi: Legal & Financial Issues* (moderated by Scott Kosnoff of Faegre Baker Daniels LLP), Patrick Cantilo (Cantilo & Bennett, L.L.P.) referred to the giant cloud in the movie *Independence Day* that settled over the White House shortly before blowing it to smithereens. "LTC is the equivalent of that cloud for the insurance industry," he said.

Things did get more cheerful.

Ralph Donato (LTCG) explained that companies use reinsurance for two main reasons: "financial stability and improving their risk-based capital ratio." Another benefit is "sharing knowledge with the reinsurer." LTC reinsurance arrangements "are not nearly as heavily regulated" as traditional insurance, Cantilo said, and they can be "very difficult for financial analysts and ratings agencies to detect." Donato added that the types of business listed on Schedule S were recently expanded to include LTC, but "you still don't see all the details."

Iowa Deputy Insurance Commissioner Jim Armstrong said that regulators are taking a closer look at these transactions, checking to make sure companies have done their due diligence in evaluating the financial strength of reinsurers. "We look at your processes to see if they're satisfactory," he said.

The panel on the LTC market featured (from left) Virginia Insurance Commissioner Scott White, Colorado Commissioner Michael Conway, Vince Bodnar (Oliver Wyman), Marie Roche (John Hancock Life Insurance Company), and moderator Stephen Serfass (Drinker Biddle & Reath LLP).

The financial supervision regulatory panel featured (from left) Ann Kappler (Prudential Financial), Christine Neighbors (Ameritas), Tom Sullivan (Federal Reserve), and moderator Pat Hughes (Faegre Baker Daniels LLP).

"In the LTC space, we're very concerned by some of the actuarial assumptions being used. We're also worried about public perception."

According to Donato, there are "significant conversations about reinsurance in the LTC market," in part because of improvements in the market itself. "It's not all doom and gloom," he explained. "We're seeing claims experience materialize, and that cone of uncertainty is shrinking." Armstrong agreed, but Cantilo warned that "reinsurers have taken on a lot more LTC liability than they were paid for." He did note that LTC risk is "pretty well distributed" across the reinsurance market.

The LTC market was the focus of *Long-Term Care: Legal, Regulatory & Business Developments*, moderated by Stephen Serfass of Drinker Biddle & Reath LLP. Virginia Insurance Commissioner Scott White and Colorado Commissioner Michael Conway, who serve as Chair and Vice Chair, respectively, of the NAIC's Long-Term Care Insurance Task Force, assured attendees that the NAIC "has been grappling with the issue of LTC long before the creation of this task force," according to White. "We do see this as an actual threat to the state-based system," Conway added.

The task force has a number of working groups analyzing areas such as rate review, benefit reductions, non-actuarial considerations, and restructuring techniques. "For all these working groups, the underlying issue is fostering more uniformity," Conway said. Enhanced uniformity would be great news for the industry, according to Vince Bodnar (Oliver Wyman), especially when it comes to rate review. "What really drives the industry crazy is not knowing what the standard for approval is."

Without standardization, Bodnar explained, you have a situation where one state approves a rate increase and another doesn't. "Every day that goes by, you're creating a subsidization," he said, where one state's residents are contributing more to the company's assets than another's.

Marie Roche (John Hancock Life Insurance Company) seconded Bodnar. "The significant lack of uniformity continues to be a problem," she said, as does the length of the rate review process, which can take years. She acknowledged that the companies have to do their share. "When a company doesn't do their homework, or is slow in responding to questions from regulators, that's problematic." Overall, though, she's optimistic. "We've seen more positive movement in states that have declined rate increases in the past," she said. "We're beginning to see breakthroughs."

Of course, regulators and industry aren't the only players on the field. Some states are considering legislation that would impose annual caps on rate increases. Can regulators work within those constraints? "That certainly is a challenge," White said, but regulators can still approve increases in a timely manner, and the industry has said it can work within the caps. Conway acknowledged that NAIC Model Acts can't be too prescriptive. "There's a sensitivity to creating models that go too far."

Small Packages & More

In addition to being the only presentation that featured Jack Burton quotes, *Big Trouble in Little China: Legal & Operational Challenges in Small Insolvencies* (moderated by Joel Glover of Faegre Baker Daniels LLP) provided an inside look at some of the big issues—such as ACA compliance, asset valuation, and holding company structures—that can arise in even the smallest of insolvencies.

One of the thorniest issues is often technology, or the lack thereof. "Old technology is a big issue," said Mark Femal (Strohm Ballweg). "You end up doing things manually to make up for the lack of tech." Moving the business to a TPA with newer systems can be difficult, so task forces often look to the failed company to act as TPA. Todd Thakar (California Life & Health Insurance Guarantee Association) said that, in a recent insolvency in which policy administration was done manually, "we were dependent on a single employee." James Kennedy (Texas Department of Insurance) recalled a company that had a single laptop computer—complete with ransomware.

Record retention can also be a problem. Kennedy mentioned one company in which the employees had thrown out most of the records. In another, the company kept files that should have been discarded years earlier. The files had no value, but the only way to confirm that was to go through each one. That took time—and money. "People are asking, 'Why is this tiny receivership costing so much?'" he said. "You have to go through it all."

According to Femal, the key to success is "building relationships with the Special Deputy Receiver and the company people. If you can gain their respect, it's such a positive. I think both parties want to take care of the policyholders."

Thakar detailed a laundry list of issues his association has faced over the past few years—ACA compliance, claims from the CMS, getting approval for replacement policies, office walls that doubled as company assets—and concluded, "you see a little bit of everything in an insolvency."

Moving from small insolvencies to large changes in the tax code, *Impacts of Recent Federal Tax Law Changes on the Insurance Marketplace & Tax Prognostication—What May Lie Ahead?* (moderated by Margaret Sperry of the Rhode Island Life & Health Insurance Guaranty Association) took a look at how the 2018 Tax Cuts & Jobs Act affected the insurance industry.

According to Matthew MacMillan (Lincoln Financial Group), the life insurance industry did not do so well. The corporate sector will see a savings of $338 billion over 10 years, but "only $100 million of that inures to the benefit of the life insurance industry" due to base-broadening measures meant to offset some of the tax revenue reductions. The health and property/casualty industries fared better.

Adapting to the new tax code "was a bit of a long road" for insurers, MacMillan said, as companies tried to predict how the new rules would affect them. He added that guidance from the government on how to interpret the code has been timely. "I think the pace has been good." On the state level, some states are still trying to determine if they should align their tax codes with the changes or simply import the base-broadening elements without the rate cuts, which would boost revenue for the states.

Turning to the political aspects of tax and spending legislation, Helene Rayder (also with Lincoln Financial Group) said that "I think the House and Senate would like to raise the spending caps for two years" (less than a month later, she would be proved correct). She stressed the difficulty of passing any legislation these days, and said the upcoming elections won't make things easier. "After September or October, it becomes increasingly difficult for Congress to act in a bipartisan way." She added that, if the ACA is struck down by the Court of Appeals next year, Congress could move quickly to replace it.

One place where speed is at a premium is the world of cybersecurity, where the threats seem to change on an almost daily basis. The panel *Liability & Regulatory Issues in Cybersecurity* (moderated by William Goddard of Day Pitney LLP and the University of Connecticut School of Law) explored the latest threats to companies, with Hilary Wells (Lewis Roca Rothgerber Christie LLP) reporting that "e-mail is more dangerous than ever." However, that threat has shifted from attempts to download malware onto a company's system into efforts to trick people into giving information away. This technique, known as social engineering, now makes up 90% of e-mail attacks. Former employees can also pose a threat—Wells said that a recent study reported that more than 25% of employees admitted to stealing company data when leaving a job.

["Welcome to the Revolutions" continues on page 32]

The freewheeling health insurance panel featured (from left) Keith Passwater (KTPassCo), Greg Martino (Aetna), Pennsylvania Insurance Commissioner Jessica Altman, and moderator (and NOLHGA Board Chair) Susan Voss (American Enterprise Group).

NOLHGA Conversations

"When We Have an Insolvency, We've Failed"

The leaders of the ACLI and NAIC discuss insurance regulation, the future of long-term care insurance, the Insurance Capital Standard, and more

Susan Neely is the President and CEO of the American Council of Life Insurers (ACLI). Eric Cioppa is the President of the National Association of Insurance Commissioners (NAIC) and Superintendent of the Maine Bureau of Insurance. The following is an edited transcript of our discussion at NOLHGA's 2019 Legal Seminar on July 11.—Peter G. Gallanis

Gallanis: *I think back to about 10 years ago, when we were in this very room talking about some of the issues now before us, but under very different circumstances. The financial system was in dire straits, and there were serious concerns about the future of the American insurance marketplace. How do you perceive the general health of the insurance industry today and what the future may bring for the provision of insurance protections to Americans?*

Cioppa: I'll push back a little bit on your question. I think the financial crisis was real and significant, and I think the insurance industry did very well during that crisis—AIG aside, which is almost a given. But even with AIG, no policyholder was harmed. If you compare the number of banks that were in trouble with the number of insurers that experienced trouble, the delta between the two is significant. I just want to point that out.

Having said that, a lot of things have transpired since the financial crisis. You have the Financial Stability Oversight Council (FSOC), which was created by the Dodd-Frank Act to look at systemic financial risks, in part through enhanced oversight of "systemically important financial institutions" (SIFIs). At one point there were four insurers designated as SIFIs by FSOC. Now there are none.

Internationally, you're seeing a lot of efforts to harmonize. We have a lot more in common, if you can put the Insurance Capital Standard (ICS) aside. It is very significant, and I know we're going to talk about it during this discussion.

The concept of supervisory colleges has been an outstanding addition, I think, to the regulatory toolbox. I just participated in one recently. You sit around with the domestic regulators and the international regulators. You can have a frank discussion about the company, and you can have a frank discussion with the company management. I think that's tremendously important.

The NAIC has instituted several initiatives as a result of the financial crisis. We did some self-reflecting, and we realized we probably were not paying enough attention at a group level. We're a legal entity–based regulatory system, but we need to spend more time looking at the groups. As a result of that, we did the Solvency Modernization Initiative, which modernized our Group Holding Company Act. We instituted Own Risk and Solvency Assessment (ORSA). We instituted Enterprise Risk Management (ERM) and corporate governance.

So I think we've done a lot since the financial crisis, and I think the United States marketplace is healthy and vibrant. In Maine we've had very few insolvencies, and nationally we've had very few insolvencies. I think that's a credit to the regulatory scheme, but it's also a credit to the industry. The industry is not one to swing wildly. They're very steady, down the middle in terms of their investments and products, and I think they deserve the majority of the credit for the health of the industry as well.

Neely: I'd like to reinforce what Superintendent Cioppa just said in terms of the slow, steady, and responsible approach life insurers take to how they conduct their business. I think one of the continued areas of focus from the standpoint of ACLI is to make sure the Federal Reserve and others understand we're not banks and that we get credit, for want of a better way of saying it, for the way we operate. In other words, a deeper understanding of the things that make us unique and also why we weathered the financial crisis very, very well.

More broadly, I'd say as a result of the crisis there was this deep focus on prudential regulation, but that's closely correlated to consumer protection. Certainly, in the policy and regulatory arena, all the issues that are being discussed and are at play now really exemplify the intense focus policymakers—at the state or federal level, or even globally—have on consumer protection.

I think that's a very important and serious area of focus. But it's one that can manifest itself in lots of different ways—certainly as it relates to policy being developed at the state legislative level, which is different than through the NAIC state insurance process. It's being manifested in policy, ideas, and discussions being posited by presidential candidates. Consumer protection is an objective, a philosophy, and a point of view that is going to color a lot of our politics and policymaking for the foreseeable future.

Gallanis: *In terms of the public policy discussion of protecting consumers through regulation after the financial crisis, Dodd-Frank was passed. The FSOC was put in place. We did, for some years, have systemic regulation of insurance groups that were designated as SIFIs. Now, we seem to have moved in a different direction. In particular, we seem to have moved away from the thought that there should be a large federal footprint in the insurance regulatory space. In terms of the architecture of who should be doing what in insurance regulation, are we in the place right now where we need to be?*

Cioppa: I think we're heading in that direction. What we call Team USA—the Federal Reserve, Treasury, and NAIC representing the states—is working very closely together and working well, which hasn't always been the case. That's much more effective internationally. I talked earlier about the de-designation of the four SIFIs. I think that was in recognition of the quality of the regulatory work the states are doing.

But having said that, we need to do more. One of the NAIC's strategic priorities this year is the Macroprudential Initiative. There can be, perhaps, systemic transfer at a macro level from insurer activities. So, we—and the FSOC and the IAIS as well—are heading toward an activities-based approach. Are there activities that could translate into systemic risk to the economy? The NAIC's initiative is starting to look at that. Things like liquidity stress and capital stress testing.

Those are the areas that I think we need to do more on. We've gone down that road. At some moments it's a partnership with the federal government. I'm fortunate enough to be the FSOC insurance member. I think the NAIC representative to FSOC

should be a voting member. There's a bill before Congress that's considering that.

I saw some numbers recently showing that the insurance industry as a whole, its percentage of the country's GDP, is now larger than that of banks. Insurance is a significant part of the economy. We have to work with the federal government at some level. But at the same time, the states are the primary regulators of the insurers.

Neely: I think the world we work in now, from a regulatory development standpoint, is a complex, interconnected one. Certainly, the ACLI and industry point of view is that we respect and advocate for the primacy of our state regulatory system. But as you look at international capital standards, we're highly supportive of the good work and the harmony of Team USA—a united approach as we try to navigate the complexity of the ICS. You look at issues like standard of care. That whole issue that led to the fiduciary rule, which is now vacated, came out of Dodd-Frank. We often use the metaphor at ACLI of three-dimensional chess when we think about international regulation, federal regulation, and state regulation. If you know chess, the queen is the most important figure on the board. In the case of a best interest standard of care, the NAIC is the queen on the chessboard.

But you have the SEC acting. You have state legislatures looking at some kind of action. We look at it from this complex perspective of, how do you get to a national harmonized standard of care or a national harmonized regulation? The NAIC model approach is a sound one, and we try to aid and abet that by providing our information and point of view as they're developing Model Acts. After you have a model, we're advocating for passage in all 50 states.

There's always been interconnectivity, but I think we're seeing an intensification of that. We support the primacy of the state regulatory system. But there are a lot of other players and points of view that have to get addressed as part of an ultimate national harmonized regulatory approach.

Gallanis: *A lot of people thought that, after the Affordable Care Act was passed in 2010, we'd see some level of order and stability in the markets. Yet those markets seem perhaps less orderly and stable than they were before. What are state regulators and the NAIC doing to help consumers through these confusing times of what seems to be unceasing change in the health insurance world?*

Cioppa: The ACA is a perfect example of a partnership that really shows what happens when both sides aren't going in the same direction. The federal government created the ACA and then almost immediately tried to destabilize the ACA. Insurers, above all else, like stability and predictability. I think as regulators

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>
> **—Susan Neely**

we're trying to stabilize our markets at the same time the federal government is trying to destabilize those markets, which is making it very challenging.

We need to spend more time, not just with commissioners but with the country as a whole, talking about controlling health costs. Because the ACA basically subsidized premiums for those up to 400% of the poverty level, but if you look at what's going on—I don't care if it's small group, large group, or ERISA plans—it's becoming increasingly unaffordable.

I think you're seeing the NAIC and state insurance commissioners sending that message just as loud and clear as we can: that we need to start looking at the cost drivers in health insurance. Having said that, there are things that I think you'll see the NAIC start promoting. Reinsurance is one of the most valuable tools we have. You see it in the individual market, but as the Maine Superintendent, I'd like to see reinsurance applied to the small group market. I think the small group market is showing extreme signs of duress, and it needs some help.

I'll wind up by saying we need stability in the marketplace, and you're seeing all of us ask for that. We need to start addressing the hard question of controlling costs. As Massachusetts Commissioner Gary Anderson said earlier this morning, insurance is intimate and there's no more intimate product than health insurance.

Gallanis: *If the fears of getting sick and not being able to pay for care are among our greatest social concerns, so too I think are fears about being able to afford retirement at some level of comfort and dignity. It's said sometimes that Americans are now facing a savings crisis, particularly with respect to retirement. Susan, could you share your thoughts about whether we do indeed have a problem with a savings crisis? If we do, what role is there to play for the life insurance industry?*

Neely: The short answer to the question is yes, we have a savings gap if you factor in all the things at play. People are living longer. That's a good thing if you are healthy and have adequate savings. The old pension is virtually obsolete. Social Security was never meant to be the sole source of retirement savings, but it is for some. Social Security won't be able to fully pay its bills within 15 years. There are roughly 16 million Americans working in the gig economies who don't have access to retirement savings vehicles through their employers—a system that we know works.

When the ACLI leadership had a chance to meet with Superintendent Cioppa, Commissioner McPeak, and others at the NAIC meeting in San Francisco, you all said, "This is the topic the world over: the retirement savings crisis and how we're going to address it."

So yes, there is a crisis. I think there's also a leadership opportunity for this industry. One of the soapboxes I've been on since I started at ACLI is that I think for the industry to be better appreciated and valued by policymakers and regulators outside those in this room, we need to take stronger positions around solutions to the big societal issues that are facing the country and the world.

One of those is the retirement savings crisis. We can't just walk into offices on Capitol Hill or the state capital or the NAIC and say, "Here are all of the things wrong from a technical standpoint with what you are proposing" or "Here's what we'd like to see better from the standpoint of our business." We need to take that broader view of what's meaningful to consumers and how we can address the societal need that is on the table. It's a matter of thinking about ourselves more as problem solvers. I think that enhances the value proposition, the relevance, and the influence of this industry.

The retirement savings crisis is a prime opportunity. No other industry offers a lifetime payout guarantee to consumers in terms of their retirement savings options. So we're actively advancing policy that we think will address that. For those following the activity on Capitol Hill, there's a chance to actually pass a bill. It may be one of the only ones that pass between now and the election of 2020.

I was on a panel at Insurance Europe in Bucharest and commented that we're moving quickly to the place in the next couple of months where nothing will move in Congress until 2021. There was a gasp in the room, and they said, "Really—18 months of no action?" I said, "Yes, 18 months of no action is very possible in terms of how our process works." But we have a chance of getting an important piece of legislation advanced through Congress that would provide retirement savings.

It really allows the private sector, our industry, to do what it does well, which is provide retirement savings options. It incentivizes the private marketplace. It would provide retirement savings options to 700,000 more Americans. We have others on the docket that we're using some of our advocacy muscle to try to advance. Again, all around trying to be a problem solver. Really be front footed on a foursquare position to help address the retirement savings gap in this country.

Gallanis: *Superintendent, a topic that's related to the provision of retirement savings is whether people will be able to pay the costs of long-term care, especially in their retirement years. Many carriers have stopped writing traditional long-term care insurance. Commissioners, when they're not worrying about the health marketplace, are grappling with whether and how to approve premium increases for existing policies that now appear to have been underpriced. What is the NAIC doing to address those challenges?*

Cioppa: The NAIC and the commissioners did things a little differently this year in how we set priorities. We tried to set strategic priorities as a group, and the number one priority that everyone agreed on is long-term care insurance. Especially as it relates to the closed blocks of business.

There's such a need for a long-term care product in this country. A lot of people seem to assume Medicare is going to pay for long-term care insurance. It does not, of course. So you're left with Medicaid—and state budgets are already straining with Medicaid expenses—or self-funding. In Maine, a nursing home costs almost $100,000 a year, so self-funding is only an option for a very, very small minority of the population.

The backdrop of all this is that the insurance industry came out with the product 30 or 40 years ago. It was a new product. And look, no one's wearing a white hat in the long-term care closed block issue. But it was mispriced. It missed all the assumptions—even under rate stability, which in Maine was around 2004, where they supposedly were pricing it under actuarially adverse scenarios. Those products are still under the same stress.

We really have two issues with long-term care. One, how do we—the industry, not regulators—come up with a product that works, that provides viable benefits at a reasonable price that Americans will buy? I think there's a huge need for it.

But what's occupying a tremendous amount of regulators' time is closed blocks. Over 100 companies were writing long-term care 20 years ago. Now, there are fewer than 15. But we see a lot of activity around the closed block issues. You talked about rate increases. Well, we have an NAIC task force looking at how we can get consistency across rate increases, approaches, and approvals nationwide. Because, quite frankly, you're seeing a lot of discourse among our members when it comes to approving rate increases. Some states are approving a lot more than others. Those states that are approving large rate increases are saying, "Wait a minute. This product is really a national product. Why are my citizens seemingly subsidizing other states?" We've got this task force led by Scott White, the Virginia commissioner. We're making headway. We're developing workstreams to address this issue. But make no mistake about it, this problem cannot be solved by rate increases alone. It's too large.

The other issue we're working on is reserves. We need to know the magnitude of the problem. When you see the numbers—GE had a $14 billion adjustment. That's a reinsurer. We as regulators need to determine the magnitude of the problem, and we're doing that with something called AG 51.

The industry is not one to swing wildly. They're very steady, down the middle in terms of their investments and products.— Eric Cioppa

The way that's working, Peter, is that we're surveying the top long-term care writers. Looking at morbidity, mortality, interest rates, lapse rates—the assumptions that matter for long-term care. We're looking at outliers. Then the actuaries who are looking at that are dealing with what's called FAWG—our Financial Analysis Working Group—to say, "Well, these companies seem to be outliers" or "These companies are having huge long-term care reserves that we really don't understand." And then FAWG is working with the domestic regulator.

We're really spending a lot of time and effort on, one, trying to define the magnitude of the problem, and two, trying to get our arms around how we can resolve it. Because at the end of the day, when I said no one was wearing a white hat, the regulators are going to own this problem as much as the industry.

It's a problem we have to fix because, when you step back, all the people who bought long-care insurance did is buy a product that was sold as a level-term premium. Although every contract I've looked at clearly indicates rate increases can happen. But they're saying, "Wait a minute. I'm doing what everyone said I should. I'm trying to take care of my own long-term care needs." Now, when they're getting ready to use their product, they feel like they're being penalized.

The last point I want to make is, we all know Penn Treaty. Penn Treaty's a $3 billion to $4 billion insolvency that all of you are dealing with. We don't want more insolvencies, because, let's face it: When we have an insolvency, we've failed. It's our number one priority for 2019. We need to solve it. We realize that, to use that cliché, failure is not an option. But it's got all of our attention in a meaningful way. During the debate about establishing the latest task force, one of the commissioners used a Ben Franklin quote, which I won't get quite right: "If we don't hang together, we'll surely all hang separately." That's paraphrasing, but it got the point across to all the members.

Gallanis: *Going back to the issue of regulatory evolution, another trend that was set in motion at the time of the financial crisis was the move toward internationally recognized standards for the regulation of insurers. As with FSOC, there was initially an effort to identify systemically important entities. Now, both the U.S. and international authorities have moved in the direction of focusing on systemically important activities. The international authorities have also been exploring whether and how to establish and monitor standards for capital—the so-called Insurance Capital Standard, or ICS. Susan, how do your member companies view the current state of development of the ICS project?*

Neely: Our position is that the ICS, perhaps well-intentioned, is not fit for purpose. We are fully supportive of the primacy of our state regulatory system, and we think that the ICS needs to recognize that and not compromise our industry's ability to provide long-term guarantees and the products that address things like the retirement savings crisis. Or compromise our ability to make investments in infrastructure that are sorely needed in this country and elsewhere. So we're very supportive of the work of Team USA, and we're doing our best to advocate for the U.S. approach and regulatory system being a part of whatever the outcome is.

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> **—Eric Cioppa**

Superintendent Cioppa is probably more familiar than I am with the strategy going into this key meeting in Abu Dhabi with the IAIS. It's our hope that the testing period of five years will be acknowledged, and that we will have time for an impact study, group capital calculation, and field-testing to provide the empirical data that will help advance our case. But we're united with the NAIC and Team USA in what we're trying to achieve. We're optimistic that the IAIS has acknowledged our point of view and our concerns.

You need to look at outcomes." We protect policyholders at the legal entity level. Capital's not fungible in our system. In other words, we can lock down capital at a legal entity when a company's in trouble by dividend restrictions.

They don't have these powers in Europe. So, we're advocating very forcefully—you need to look at our system as a whole. I was just in London before coming here, and I had some discussions saying, "Comparability has got to be on the outcome basis. What's the outcome we want? We want to protect consumers." We think our system has demonstrated that time and time again and is effective at that.

But having said that, we are developing a group capital standard internationally. We're calling it the Aggregation Method for the internationally active groups. We are pushing very hard to get the construct of, what are the comparability guidelines we have to follow to have it judged comparable at the IAIS?

It is a pretty intense discussion. We are in a distinct minority in this field. A lot of the jurisdictions are buying into the current ICS, and we're pushing back. At the end of the day, we've made it clear we're not going to adopt something that's not fit for purpose for our country. Can you truly have an international standard when you have the largest insurance market in the world saying, "We're not going to adopt it"?

Gallanis: *Superintendent, do you have some observations on that?*

Cioppa: I do. Somehow Boston is a good setting for this, given the revolution. It started here.

I was thinking about the ICS when you started talking about the retirement savings initiative and crisis in this country. From our perspective, consumers should have the opportunity to purchase a product and to transfer their longevity risk to an insurer. We think that those products are incredibly important to our economy and our citizens.

If you talk to insurers in Europe, they'll tell you that those products have disappeared—largely because of Solvency II, which the current ICS is based on. We've pretty much drawn a red line. Secretary Mnuchin at our international forum came out and gave a very strong speech saying the ICS as it's currently constructed is not fit for purpose. Team USA has been united on that.

This is an incredibly important issue because, as you said, defined benefit plans are disappearing. These products are important. We don't have the same social safety net Europe has. This is a fight worth having. I think you mentioned the Group Capital Calculation, or GCC, which is going to be the foundation for something called the Aggregation Method. That's going to be our proposal internationally.

We're very strong in saying, "You can't compare ratio to ratio.

Gallanis: *Let's move to a couple of other topics. The first involves the continuing revolution in technology and how it relates to the insurance marketplace. How do we balance the benefits of these technologies with concerns about privacy or financial risk when things go wrong?*

Neely: First, more data provides this industry with the opportunity to continue to be innovative in underwriting. How do you do that appropriately with consumer protections? In every market consumer research survey you see, consumers want two things: transparency and the ability to protect their own information. Balancing the opportunity that data provides to innovate and develop even more customized products that provide coverage to more people with adequate consumer protections is a challenge.

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> **The ACLI Board feels that, ultimately, there's going to be federal legislation that will be all-encompassing and address all sectors that are involved in the use of people's data.**
> **—Susan Neely**

Everybody in the industry is grappling with it and investing time and resources and energy to solve it.

It's also manifesting itself as a big policy debate in state legislatures across the country. I think that as many as 30 were looking at privacy legislation in the last round of legislative sessions. Congress is actively engaging in it. It's a mind-share discussion right now in Congress. There are no actual bills, but there are strong points of view and a lot of information gathering that's being led by members of Congress and legislators on both sides of the aisle.

From the ACLI standpoint, we want to make sure that the special needs of insurance are reflected in whatever policy is advanced. You look at the daily frontpage headlines on some new security breach from Facebook or Google or another technology-based company. We're getting swept into policy discussions that are being driven by concerns around them and their business practices.

It's a complicated landscape, and it's one that we need to be engaged in everywhere. The ACLI Board feels that, ultimately, there's going to be federal legislation that will be all-encompassing and address all sectors that are involved in the use of people's data. We want to be treated fairly as a part of that, and we probably need federal preemption to ensure that, again, we have a national harmonized approach to how consumers are protected and that our ability to continue to use data and information for underwriting is protected. Now, who will be the enforcement entity? These are complicated things that still have to be resolved. But that's the evolution of our thinking.

Cioppa: Obviously, it's a huge issue. I would push back on the need for federal preemption. I'm certainly not surprised at ACLI's position. I mean, we have the NAIC model that we've recently adopted and several states have already adopted. I think states need to accelerate the adoption of that. Having said that, cyber and data and big data is a huge issue. We could spend all day talking about that. We have the innovation task force at the NAIC. Big data is one of the working groups. In the end, these algorithms and these underwriting tools of insurers, whether it's life insurers or P&C insurers, are becoming increasingly complicated and complex.

I think the role of the NAIC is to say, "What are the guardrails? What are the rules of the road that we have to lay down?" Because you don't want to stifle innovation. Innovation in and of itself is almost always a positive, but not always. So what do we have to do? Through some of these underwriting models, there is some segment of society that is going to become uninsurable. What are the ramifications of that? I think we need to really step back and say, "Is that desirable?"

But at the same time, what's the balancing act? The better underwriter a carrier is, the better results they have. After all, underwriting in its basic form is some form of discrimination. Where's the line with that? One of the things we were looking at, at the state level and through the NAIC, is how the state is going to look at these algorithms and look at these models in a meaningful way. Because a state like Maine is never going to be able to afford data scientists and actuaries who are specializing in model review. So we're looking to see if there's a way to pool resources at the NAIC to help us evaluate, but not cede our regulatory authority in the ultimate decision making. But we're going to have to be nimbler and more efficient in this new world of analytics that's coming.

I think that's one issue. The other is data privacy. I mean, you look at what's going on in Europe. They've settled who owns the data. We have not settled that at all in this country. That issue is still being debated, and I don't know how it's going to be solved. But you talk to millennials, they don't seem to be as excited as people my age about the data being out there and being used. They just want to be able to do everything over their phone.

I think we've done a good job as state regulators trying to engage the innovators, and the innovators include insurers that are developing with firms in Silicon Valley. I don't think we need sandboxes to allow innovation. I think the laws in the United States are flexible enough, and we're trying to actively engage innovators and carriers. What are you thinking about developing? What products are you thinking about bringing to the marketplace?

A good example of an area I think we need to review is the whole rebating model in this country. First of all, I've never had a consumer complaint saying, "I've got a rebate from a carrier. That's a bad thing." But in all seriousness, as an example, I'm talking about wearables that carriers want to offer, like Fitbits. That should not even be in the discussion of rebating, in my opinion. That's not an NAIC opinion. But it's a service that carriers need to offer, and I think carriers need to start differentiating themselves by their level of service and innovation. The NAIC's job and the states' job is, how do we foster that while drawing some guardrails? We want to engage the industry in trying to develop those in a meaningful and substantive manner.

> **The concept of supervisory colleges has been an outstanding addition to the regulatory toolbox. —Eric Cioppa**

Gallanis: *Another balancing question that's gotten a lot of attention is the issue of balancing the provision to consumers of a generous menu of product and service choices from the industry while also protecting consumers from the sale of products that might not be suitable or in the best interest of those consumers. How close do you think we are to reaching a consensus on how to address that particular balancing question?*

Cioppa: We are working on that, and Jillian Froment from Ohio is leading the effort. We recognize that we have to develop a model. The SEC came out with its model. It's got a best interest standard. They didn't define it as well as we had hoped, and we're looking at that issue. But we recognize there's some need for harmonization. We have to come up with a model, and we have to do it in a fairly expeditious manner. Again, I think it was our third or fourth strategic priority for 2019. We recognize the landscape we're operating under, and we're working diligently to try and come up with something in a meaningful way.

Neely: I was listening closely, and all of that was very affirming. As I said earlier, the NAIC is the queen, the big piece on the chessboard. We want a national harmonized standard of care. We support some strengthening of the existing suitability model. We support best interest. Our strong hope is that the NAIC does adopt a model that provides some enhanced consumer protections as soon as possible. Because there's a concern that state legislatures will act independently and create some confusion. That's not desirable from our standpoint.

I listened with great interest to what Superintendent Cioppa said, and I'm hopeful that maybe this year the national model could be adopted. Then we see our role as encouraging states to embrace the national model so that we achieve the harmonization we're looking for. ✯

NOLHGA Conversations

Rational Actors v. Unrealistic Optimists

The author of *Nudge* offers his insights into behavioral economics, some recent Supreme Court decisions, and whether there are brownies in hell

While teaching at the University of Chicago, Cass Sunstein became one of the first legal academics to devote significant attention to the evolving field of behavioral economics and how it applies to law and public policy. He served in the Obama Administration in the White House Office of Information and Regulatory Affairs and is the founder and director of the Program on Behavioral Economics and Public Policy at Harvard Law School. He is the author of a number of books, including Nudge: Improving Decisions about Health, Wealth, and Happiness *(with Richard H. Thaler);* Why Nudge?*; and* How Change Happens. *The following is an edited transcript of our discussion at NOLHGA's 2019 Legal Seminar on July 12. —Peter G. Gallanis*

Gallanis: *For a bit of background, can you give us some thoughts on how the new-ish field of behavioral economics adds to the classical economic view of how decisions are made?*

Sunstein: I was at the University of Chicago for a long time. And there were something like 87 Nobel Prizes awarded in my first three years. Not quite that many, but a lot. And people said that the best way to think about human beings and to think about law is to assume people are rational actors.

These were people who were often on the tennis court, kind of crazed. They'd hit topspin forehands they didn't know how to handle. Or people who would complain about their summer home and how silly they were to purchase it. Or people who would talk about what a bad decision they made to marry their spouse. And the self-reported investment behavior or insurance behavior of the advocates of rational actor models, according to the people who were engaging in the self-reports, was not rational.

So, what behavioral economics does is try to do economic theory and kind of daily legal and policy stuff with real human beings: *homo sapiens*, not *homo economicus*. I'll give you a few examples. People, as I'm sure you know from your jobs, often think about today and tomorrow as real and the future as Laterland, and they're not sure they're ever going to visit. That means that people are "present biased," and that can greatly affect decisions about economics, about insurance, about smoking, about eating, about everything.

We know also that 80% of people show a tendency to unrealistic optimism, which means that they think they are above average in terms of their susceptibility to various risks: 94% of university teachers think they're better than the average university teacher; 90% of drivers think they are better than the average driver, less likely to be involved in a serious accident; and 100% of people believe that their sense of humor is better than average.

If people are unrealistically optimistic, that can create a lot of trouble. Present bias—a focus on today and tomorrow and not a decade from now—and unrealistic optimism, that's a very potent combination.

We also know that when people assess risks—

and this is the third on my trilogy of relevant human, let's say bounded rationalities—they don't run the statistics. They think, "Can I think of an example where this came to mind?" And if they can think of an example, then the probability assessment shoots up. If they can't, then it shoots down.

There was a time in New York, where I was living at the time, when people were really scared they were going to get Ebola, even though more Americans had married Kardashians than had died of Ebola. And people weren't going around thinking, "Oh my God, I might marry a Kardashian." The reason for the crazily inflated risk perception was that the one case where someone had died from Ebola was widely publicized. Which made people think, "Oh, that could be me." And that made the probability assessment go haywire.

My co-author Thaler got the Nobel Prize in 2017 for the economic work on things like present bias, unrealistic optimism, and poor probability assessments, and that has led to rethinking law and policy. So what should we do with respect to, let's say, the Department of Labor's regulation of the insurance market, given what we know about what people are like? Or how should we handle the problem of poverty, given what we know about how human beings behave? That's a revolution, and we're right now in the early adolescence of the revolution. That is, this is not mature by any means. Its voice is starting to break, if it's a boy.

Gallanis: *What I'm hearing you say, and what I understand from your books, is that where classical economics provides a theory, behavioral economics gives insights on how the workings of the theory are mitigated by the way human beings really act.*

Sunstein: Let me give you an example. My longtime colleague, Ronald Coase, got the Nobel Prize for what I think is the most influential single article in all of law. It's called "The Problem of Social Cost."

Present bias—a focus on today and tomorrow and not a decade from now—and unrealistic optimism, that's a very potent combination.

What Coase says is, if people don't have any costs in transacting, if they can bargain their way costlessly where they want, then it doesn't matter who gets the entitlement. If you initially give people an entitlement to, let's say, pollute, and the victims of pollution have to buy them out. Or if you give the victims of pollution an entitlement to stop the polluting, and the polluters have to bargain, it doesn't matter.

It really doesn't matter. They'll bargain their way. So long as they can transact costlessly, they'll bargain their way to the efficient and same solution.

The Coase theorem is basically bedrock in the Federal Communications Commission and at law schools all over the country. But it's wrong. It's not right. If this half of the room got a Boston Red Sox mug and this half of the room didn't get a mug, and you asked this group, "How much would you sell that Boston Red Sox mug for?", it's going to be higher than this group is willing to pay to get a Boston Red Sox mug. And that's not because this half of the room likes the Boston Red Sox better than this half of the room. It's that whoever gets the entitlement first, values it more.

And that suggests you're not going to get the same solution regardless of who initially gets the entitlement. If you tell people in a negotiation, "You have the right. Do you want to sell it?", they're going to value it more highly than if you tell people, "You don't have the right. Do you want to buy it?"

I've recently done these studies with respect to privacy. I'm going to give you the approximate number. I might give you the exact number. I think I have the exact number. If you ask Americans, "How much would you pay to have privacy protection on Facebook?", they'll pay $5 a month. Not a lot. If you ask similar Americans, "How much would you have to be paid to give up your privacy on Facebook?", they'd say $80. It's supposed to be the same. It's not.

Now that has big implications. Because whether someone has an initial entitlement is often an artifact of law. The law can give the initial right to polluters or instead to people who are victims of pollution. Or it can be just an artifact of language. You can just describe it one way or the other. And if you describe it as, "Do you want to pay to get savings from energy conservation?", you get a much lower number than if you tell people, "You're going to lose something if you don't use energy conservation methods. How much is that worth to you?" Then they're going to get energy conservation methods.

Gallanis: *So one of the challenges here is how to take those insights about how people actually behave in the real world and develop—whether it's in the private sector or the public sector—a backdrop or decision-making architecture so that people will come to make decisions that really are better for them.*

I have exhibits A and B here from my hotel room. This card says that the hotel supports sustainability and that if we want our bed made with fresh linens, we should put the card on the bed. Otherwise they'll just use the linens that are on the bed. And this card says that if you want to support sustainability by reusing your towels, just hang the towels on the towel rack. Are those "nudges"?

Sunstein: Absolutely. Nudges are approaches that preserve freedom of choice, that impose no cost, material or otherwise, on people, but steer people in the preferred direction. Think of a GPS device as a nudge. If you don't like the route it gives you, you can ignore it. But it will give you a route that will get you where you want to go.

A nudge is an intervention that allows people to go wherever they want but steers them in a particular direction. It's profoundly to be hoped, in a direction that is in their interest. A warning is a nudge.

A calorie label is a nudge. Automatic enrollment in a savings plan is a nudge. Disclosure of what the social norm is, is a nudge. A reminder is a nudge. And many of these things are saving lives today.

Gallanis: *Does nudging always involve by definition free choice on the part of the person at whom the nudge is aimed?*
Sunstein: Completely. If you eliminate free choice or compromise free choice, that might be a good idea. But you're not in the domain of nudging anymore.

Gallanis: *And does nudging always involve some sort of a default setting where there is a choice or preference that's determined by someone other than the chooser?*
Sunstein: Use of the default setting, as in the examples you gave, that *is* a nudge. But that's not the *only* kind of nudge. When I was in the U.S. government, we worked on a response to the fact that a lot of American poor children who are eligible for free school meals aren't in the program. This is breakfast and lunch for poor kids. It can make a massive difference in the life of the household, and they're not signed up. What do you do?

What we did was a program called direct certification, where if the locality or the school knows they're eligible, they're in like that. They don't have to participate. They can opt out for the year or for the day. But they're in like that. It just shifts the default.

That is a nudge. If your printer has a default double-sided setting, that's a nudge. Your cellphone has a lot of default settings. Those are nudges. The Penn Medicine Nudge Unit—a health unit at the University of Pennsylvania—is doing a lot of things to respond to the health problems patients face and things that doctors do. Some of those things, the responses that are nudges, they have nothing to do with default rules.

A nudge is an intervention that allows people to go wherever they want but steers them in a particular direction.

If you remind doctors that they're in the upper 10% of opioid prescribers or antibiotic prescribers, they're not proud of that. They're outliers. They don't want to be outliers. They don't want to be big on opioids or big on antibiotics. So that cuts prescriptions. That's not a default rule.

If you ask people to choose when they get their driver's license whether to be organ donors or not, that's forced choosing. It's not a default rule. It's completely a nudge, and it increases the availability of organs for transplantation. If you go to a McDonald's and have calorie labels on the food, that's not a default rule, but it is a nudge. It nudges you to take fewer calories on.

Gallanis: *What alternatives to nudges exist for promoting better decisional outcomes for individuals?*
Sunstein: You could have a tax. Many localities are thinking of soda taxes as a response to the obesity problem. That's not a nudge. You can have a subsidy. Some governments have subsidized electric cars as a way of encouraging usage. That's not a nudge. You could have a prohibition, accompanied with a small or large fine, as a response to smoking. You can say if people smoke here, you will have to pay a little fine. That's not a nudge. You could have a mandate, so that people are required to buckle their seatbelts or are forbidden from texting while driving. Those things are not nudges.

Gallanis: *Is there something about the concept of nudging that makes it inherently better than those alternatives, or does it really just depend on the situation involved?*
Sunstein: The moral case for nudging is rooted in the fact that it's freedom-preserving. In the United Kingdom, Prime Minister Cameron created a Nudge Unit in 2010. And there are now, depending on how you count, somewhere between several dozen and over a hundred nudge units all over the world. There's one in Japan. There's one in the United States. There's one in Germany. There's one in Australia that's doing fantastic work. Qatar has created one. One has recently been created in Rio de Janeiro.

And the appeal is, we can get real results from the public sector without doing anything to compromise people's freedom. There are companies all over the world, including in the insurance sector, which are using behavioral strategies for promoting better outcomes, thinking that if you're talking about customers or employees or clients, what is respectful of their autonomy and what is often appealing to

NOLHGA Conversations

> **The moral case for nudging is rooted in the fact that it's freedom-preserving.**

them is the sense that their own agency is being respected. That they can do what they want.

That's a kind of moral case for it, as opposed to a ban. If people are told the calories associated with brownies, that's less invasive than saying, "If you want to buy a brownie, you're going to have to pay us something."

Gallanis: *Or that you're not permitted to buy a brownie.*

Sunstein: Yeah. That would be hell. I think actually in hell. Please be good while you're alive, because in hell there are no brownies. It's really bad.

The more technocratic case for nudging—and I confess, it's a terrible confession, but this is where I live, what I'm about to tell you—is, the way to choose between nudging and the alternatives is what produces greater human welfare.

Typically, a nudge will be really limited on the cost side, and on the benefit side it will be positive. But how positive is TBD. If you remind people of something, that's usually really low cost, but are you going to get a small benefit or big benefit? TBD. In some cases, reminders are fantastically effective. In other cases, they have a modest effect. If you can get through a ban on, let's say, theft, that's a much bigger impact than you can get from a reminder not to steal from people. Then go for the ban. It has higher net benefits.

In the government, and this is true under President Trump as well as under President Obama and their recent predecessors, the religion is cost-benefit analysis and maximize net benefits. There's no church that's going to be very much interested in that. But it is, I think in terms of surveying the American people, a good place to be. Nudges will often have benefits in excess of cost, and sometimes they will be the way to maximize net benefits. But not always.

Gallanis: *You raised the notion of the moral implications of this approach. If nudging has been something of a cottage industry among academics, there also seems to have arisen a somewhat smaller (but not negligible) cottage industry of people who have raised moral or other objections to the nudging approach. What are some of those objections, and what do you think about them?*

Sunstein: I think you have the exact right phrase: cottage industry of academics. But much more interesting, and it pains me a little to say this, is the explosion of real-world action by the private and public sectors.

We've talked a little bit about governments. There are interventions that are significantly reducing opioid consumption, in a way that's reducing deaths from opioid use, that are often government-focused but hospital-driven.

I'm going to be careful here because I've worked with some of these companies and I don't want to name them. In the domain of companies that provide food and drink, there's keen interest in using these strategies, with substantial success in producing healthier outcomes. I'll mention one, because the company's been public about this. Pepsi has been very active in using behavioral strategies to encourage healthier outcomes for their consumers.

I'm more excited about the private sector and the government stuff than the academic stuff because, while the academic stuff is sometimes foundational, the real payoff for our world doesn't come from the universities.

Gallanis: *In terms of the moral objections, they often operate at a very high level of abstraction, which makes it hard to penetrate. But let's use a word: manipulation. There's a concern on the part of some that there are behaviorally informed approaches that are manipulative. If people are told that they're in the upper percentile of opioid prescribers, is that manipulative?*

Sunstein: I don't think so. If people are told that the suntan lotion they're getting is protective against burning but not against cancer, is that manipulative? No. It's true. It's information. If by default, people are enrolled in a savings plan, but are told they can opt out if they like, it's very hard to say that's manipulative. You could probably find some nudges that count as manipulation. Professor Richard Epstein, whom you mentioned in your introduction, is very concerned about government error, or government bad faith, with respect to nudging. And that's fair.

Gallanis: *Some critics cite the view of economist F.A. Hayek, that the individual will always know better than a government could ever possibly know about the individual's situation.*

Sunstein: I hope Hayek didn't think that, because it's a preposterous idea. The individual knows better about what substances are carcinogenic than the experts on carcinogens? The individual knows better whether suntan lotions protect you against cancer than the people who spend their life on that? At a high level of abstraction, it's hard to get your mind around this stuff.

I think Hayek's enduring insight is that markets will encode the information of dispersed people much better than any planning body can. And the advocates of nudging agree with that, which is why they are insistent on freedom of choice.

I'm conscious that the level of expertise in this room is really high. But just name someone who's intelligent but not an expert on insurance. My sister. Smart woman. She knows a lot about a lot of things. What you do, she doesn't know a whole lot about. You know more. Now, my understanding is you all are working in the private sector. But if you worked in the public sector, you'd still know more. And with respect to people who are making choices that bear on, let's say, their economic future, Hayek would not deny that there's dispersed information on the part of people who aren't experts. It's not terrible. But it's not great.

Gallanis: *I should say that we have had a number of real experts from the public sector—six state insurance commissioners—who have participated in this conference. And I don't think there's a person in this room who doesn't have a very high level of regard for their expertise.*

When I think about nudging, and particularly nudging approaches that involve the selection of a default setting, I wonder whether the decline of trust in governments and other institutions—and the decline of trust in expertise and experts—have any material implications for expanding the use of nudging as a way of improving people's outcomes.

Sunstein: It's a great question. I'm very concerned about this. Over the past six years or so, I've been involved in trying to understand what the citizens of the world think about exactly what we're discussing. I have data from Germany, the United States, Ireland, the United Kingdom, France, Italy, Russia, China, South Korea, and about 12 other countries. And what I've learned is that the bulk of these countries show something between 70% and 80% approval of the nudges that have been discussed or adopted in democracies over the past decade.

Overwhelming approval. And it cuts across ideological lines. Republicans are not unsupportive. For some of them, the Republicans are at 68% and the Democrats are at 80%. But they're both on board. You could easily imagine some for which Republicans would be at 80% and Democrats at 68%. If you nudge people not to have abortions, you could get an ideological split. But in general, in the economic, health, and environmental area, big support.

The only countries that are material exceptions to what I just said are Denmark, Hungary, and Japan. They show lower levels of support. Now, we want to be careful about that. Because the lower levels of support aren't a lot lower. Where in Germany and the United States there's 78% approval, in those three countries it's going to be 60%.

What is going on in Japan, Hungary, and Denmark? The best we can do, and I've done this with a European co-author and kind of an international team, is to say that, in the relevant periods, levels of trust were lower in those three countries. Hungary, there's less trust in government in general. In Denmark at the time, some stuff had happened that diminished trust.

Japan, I'm not sure exactly how to explain that, but it had something to do with lower levels of trust.

So undoubtedly, trust maps onto levels of support. But for the sorts of things we're discussing, once you ask people, "Do you favor automatic enrollment in savings plans?", people like that. "Do you favor a traffic light system for food—green, yellow, red?" To my surprise, people like that too.

Partly because the intrusion on individual choice is somewhere between zero and small. People can go their own way. I have data from the United States suggesting that even when people like the direction of the mandate, they don't like the fact of the mandate. Whether they like the direction of the nudge is pretty well determinative of whether they like the nudge. If people are nudged to do something that people don't like, like spend their money on gambling, people don't like that. It's not because it's a nudge, it's because people don't like the idea of being told to gamble.

Gallanis: *If we can shift gears radically, we would welcome your thoughts on some of the recent developments in administrative law and related case law, especially at the United States Supreme Court. Attendees have been provided copies of the slip opinions in two end-of-term decisions: the* ***Gundy*** *case, involving the so-called nondelegation doctrine; and the* ***Kisor v. Wilkie*** *case, involving the extent to which courts are expected to defer to administrative agencies in the interpretation of their own ambiguous regulations.*

There is a line of decisions related to "Auer deference," the issue in the ***Kisor*** *case, that involves judicial deference to agency interpretation of ambiguous statutory provisions: so-called "Chevron deference." Since these decisions were issued, a lot of commentators have been saying that the doctrines of Auer and Chevron deference are not long for the world, and that the nondelegation doctrine may be resuscitated, after 80 years of disfavor, to start invalidating grants of authority to agencies. Is this stuff likely to happen, and how much does it matter?*

> **I have data from the United States suggesting that even when people like the direction of the mandate, they don't like the fact of the mandate. Whether they like the direction of the nudge is pretty well determinative of whether they like the nudge.**

Sunstein: I'll say a little bit on each of the three. Suppose there's some word in a rule from the Department of Labor: "diagnosis." What's a diagnosis of, let's say, heart disease? The *Auer* principle says that if it's ambiguous, the agency's interpretation prevails so long as it's reasonable. And some people have been very exercised about that, saying that it gives the agency the authority to interpret the law: "Whatever happened to *Marbury v. Madison*? It's for the courts to interpret the law."

What the court said in *Kisor* is, that's really overheated. And so, the headline is that *Auer* deference is extremely secure. We have five justices, or four, and unless one of them leaves, and even if one of them does, we can take it to the bank that *Auer* lives, exclamation point.

Now this is important, because it means that if you have some technical term in a regulation, like "carcinogen" or "diagnosis" or "artillery," the agency prevails so long as (A) it's genuinely ambiguous, and (B) the agency interpretation is reasonable. In my view, and I've spent a lot of years in government on this, that is completely the right way to go. And Justice Kagan's opinion is a masterpiece. Justice Gorsuch's opinion in dissent is extremely well done, but let's put it this way: It's not a masterpiece.

So *Auer* is alive and well. Now, if Justice Ginsburg retires, then the court will have a question whether to repudiate its own recent precedent. Unlikely, but not impossible.

Chevron says that where a statute is ambiguous, the agency's interpretation prevails so long as the agency's interpretation is reasonable. Sound familiar? It's the same idea, but assume the word "diagnosis" is not in a Department of Labor regulation, but in a statute that Congress enacts.

The *Chevron* idea has been around since 1984. It's so foundational to administrative law that to me it's startling that it's under pressure. The chance that *Chevron* is overruled is, I think, not high. Chief Justice Roberts in *Kisor* is at pains to say the *Chevron* question has not been resolved. And that means there is a question mark next to *Chevron*. It would be sur-

> ***Chevron* is a great quieter of politicization of the judiciary.**

prising, very surprising but not amazing, if *Chevron* were overruled.

I'll give you two reasons why I think in the end, Justice Roberts and potentially one or two of the others who have been uneasy about it are not likely to overrule it. One is, what happens on the day after *Auer* or *Chevron* is overruled? The Democratic appointees and the Republican appointees are going to disagree a lot more than they do now. *Chevron* is a great quieter of politicization of the judiciary. Because a Trump appointee and an Obama appointee are brought closer by knowing, if the Trump EPA has said something, it wins unless the statute is unclear or the agency interpretation is senseless.

If the idea is, what does the word "pollutant" mean with respect to greenhouse gases, the Democratic appointee and the Republican appointee with high probability will disagree. And that's not fun, to see the judiciary politicized in that way.

Even putting politicization to one side, overruling *Chevron* introduces chaos. What happens to the hundreds, maybe thousands, of judicial decisions that have been rendered under *Chevron*? Is the meaning of all those statutes now up for grabs?

And put politics to one side again. A judge will not see the word "carcinogen" the same as another judge just because the word isn't clear to generalists. As applied to imaginable, let's say maybe cancer-causing agents, there are competing definitions. This is a way of saying our agencies get to prevail in an interpretation of their own regulations under the stated conditions. That's been resolved. *Chevron* has not been resolved, but it's probably going to go the same way.

The nondelegation doctrine says something like an open-ended grant of discretionary authority to an administrative agency is unconstitutional because Article One, Section One places legislative power in the Congress of the United States. So Congress can't say to the EPA, "Do whatever you think best." If it does that, it's vesting legislative power in an agency, not in Congress.

We have to back up a little bit. It's true that the last time the Supreme Court invalidated legislation on nondelegation doctrine grounds was 1935. And the people who lament that fact say the doctrine's died. But it's in Article One, Section One.

Guess what was the first year the Supreme Court struck down legislation on nondelegation grounds? 1935. That was the last year and the first year. Which raises a serious question about the proposition that the nondelegation doctrine has been firmly rooted in our constitutional tradition and then suddenly abandoned in 1935.

Guess how many references there were to the nondelegation doctrine in the founding debates in Philadelphia, or in the ratification debates all over the young, about to be constitutional republic of the United States? Did you guess 10? None. Zero. Can't find it. There was one reference by James Madison in the debate on the Alien and Sedition Acts over a decade after. There's nothing in the founding period.

That makes it very challenging to claim that the nondelegation doctrine has good constitutional roots. In addition, early Congresses granted pretty open-ended authority to executive agencies. And within Congress, it wasn't said that this is an unconstitutional delegation. So the historical pedigree of the nondelegation doctrine is uneasy. Having said that, there might be five votes to restore it. It's possible. ✯

["Helping Hands" continues from page 1]

and high severity) creates pressure on management, especially public companies. Reinsurers can provide relief to runoff blocks of legacy LTC policies by absorbing the volatility inherent in these risks. Lastly, capital requirements are significant for direct writers, and profit levels for LTC are minimal or nonexistent. Carriers would prefer to redirect capital to products with higher profits.

The LTC industry has evolved from the time when limited data existed and actuarial assumptions were borrowed from other insurance products. Today, experience on older policy forms is credible and can be leveraged to deploy a data-driven assumption approach. This form of assumption development is very attractive to reinsurers and provides opportunities to direct writers to reinsure older blocks of business.

Capital Requirements & Reinsurance

LTC is a low frequency and high severity product. This means that events triggering benefits happen at a very low rate, but when they occur, the event (and costs) can be significant. Even looked at in large scale, quarter-to-quarter and year-to-year volatility will occur. This creates a material challenge for actuaries to identify trends versus "noise" that happens due to year-to-year fluctuation.

In addition, volatile results attract attention from investors, which creates significant pressure on the company to disclose and explain results on a regular basis. Based on discussions with investors and equity analysts of public companies with LTC portfolios, we have found that there is a material discount applied to the stock price given the poor historical experience of these blocks.

Statutory capital requirements for LTC are significant, especially in early durations. In Figure 1, the total assets required over the life of a policy are shown. The assets are separated between those assigned to statutory reserves and to target surplus.

In Figure 2, the relationship between surplus and total assets is explored. As shown, there is a significant capital requirement in the first few years after the policy is issued. This is driven by large acquisition costs, reserve patterns, and initial commissions. Nearly 100% of the assets required in these years are for surplus. Premium collection from policyholders cannot fund this surplus given the other strains of underwriting cost, commission payments, etc.

Figure 1

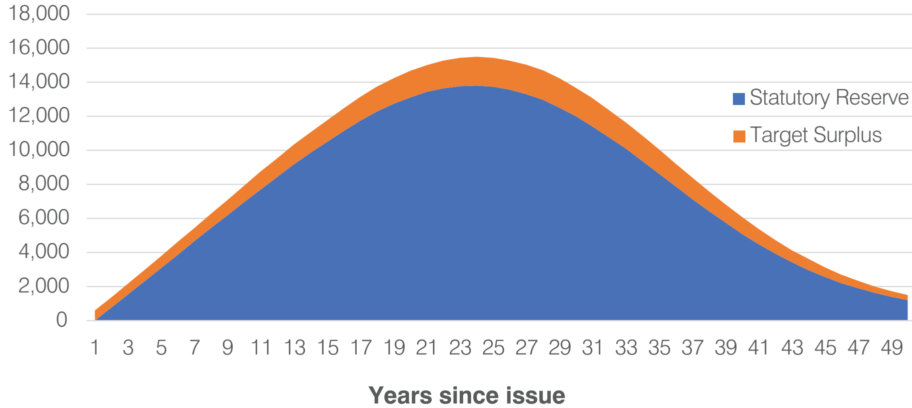
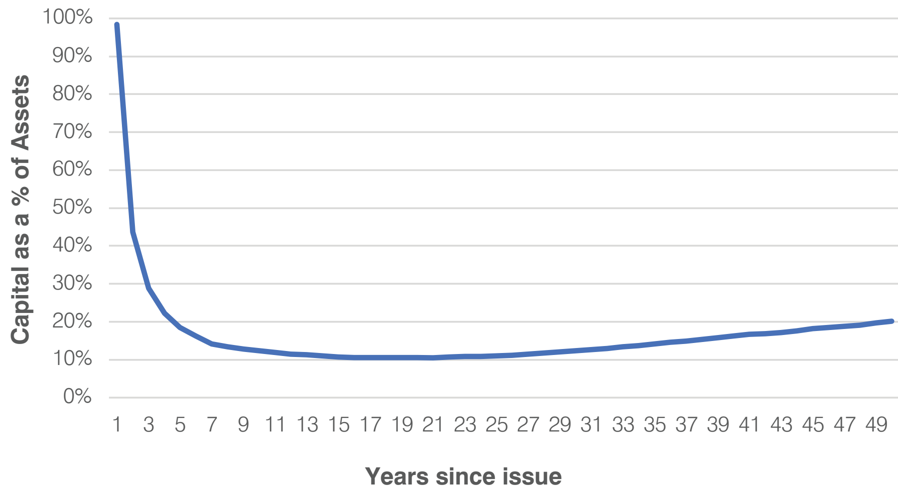


Figure 2



The capital-intensive nature of this product, especially in early durations, creates demand for reinsurance capital. Partnering with a reinsurer can help a direct writer delay or diminish the capital required initially to fund LTC products.

Future Opportunities

In the short- and long-term future, reinsurance opportunities for the LTC market will continue to emerge. Over 100 insurers have legacy blocks of LTC. As experience stabilizes, the reinsurance market will expand and likely experience more frequent LTC transactions.

The need for LTC services will increase in the United States as the population ages. Solutions for funding those services—and whether that funding should come from the public or private sector—are a frequent topic for debate in the industry and media. In an effort to meet the growing need for LTC, the insurance market has expanded into hybrid products, and there is an expectation that new designs are on the horizon. Reinsurers with product expertise, underwriting data, and administrative capabilities will emerge to help provide solutions to direct writers as these products evolve.

Reinsurance and LTC have been connected for years. Although relationships have changed over time and will continue to change into the future, this connection will remain. ✯

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["President's Column" continues from page 3]

The Challenges Posed by an LTCi Liquidation

The Adequacy of Funding Sources to Pay Claims. Whatever else may be involved, all resolutions of insolvent insurers are most fundamentally finance problems: how to maximize payment of claims on insurance policies from the inherently inadequate funding sources that are available to fund the resolution? In virtually all liquidations, the assets of the insurer are insufficient to cover all direct insurance liabilities; otherwise, the company would be sold or rehabilitated, or liquidation otherwise somehow avoided.

This column recently illustrated the steps that were followed in analyzing the finance problems that had to be solved to develop the optimal resolution plan for a very challenging liquidation of an annuity issuer, Executive Life Insurance Company of New York (ELNY).[8] Many of the challenges of the ELNY liquidation are also present in the liquidation of an LTCi writer, but LTCi cases also present some critical additional concerns.

Liability Valuation & Timing. The first step in solving the finance equation is to develop the most accurate possible projection of the failing company's policy liabilities—both the ultimate amount of the funds that will be needed to pay benefits (and to service policies and claims during their runoff), and a projected schedule of when those costs are expected to be paid. This is an exercise requiring the best available actuarial expertise for the type of liability involved—here, LTCi.

Funding Source Valuation & Timing. The second step is to inventory the categories of available funding sources and to quantify as accurately as possible both the amount of funds that can be made available and the timing of their availability: That is, this step requires a comprehensive valuation of all funding sources and projections of when cash flows can be accessed.

In LTCi liquidations, as in the ELNY liquidation, the two most critical sources of funding policy benefit payments are assets available in the estate of the failed insurer and benefits funded through the triggering of the affected GAs (which generally requires the entry of an order of liquidation and a finding of insolvency by the appropriate court in the insurer's jurisdiction of domicile).

In addition, an important supplemental source of funding in a liquidation involves net investment and reinvestment earnings on funds invested at the commencement of a resolution plan (largely made up of GA assessments and funds available from the estate of the failing company). Those net investment earnings can be a particularly important component of resolution funding, to the extent that they are intelligently managed by seasoned investment professionals, and to the extent that related expenses (including taxes) can be minimized.

In all insolvencies, premiums required to be paid on covered policies must continue to be paid after commencement of a receivership, and those premiums can also constitute an important funding source for the resolution plan.

Most premium-paying policy liabilities covered by GAs involve either short-tailed coverage (e.g., traditional indemnity health insurance, which usually terminates shortly after liquidation) or longer-tailed contracts for which premiums are fixed as of the date that each policy is issued (e.g., permanent life insurance or fixed annuity contracts).

LTCi contracts are different: By their terms, LTCi contracts *expressly permit* actuarially justified premium increases after they are issued, if the increases are approved by the applicable regulator. By the time an insurer with legacy LTCi nears insolvency, it is usually not feasible to adjust premiums across the entire remaining block of business to levels that would be required to restore the insurer to normal operations. However, it is often feasible and appropriate to adjust the level of premiums—even in liquidation—to a level comparable to the levels that regulators are approving for similar coverage from other companies that are not in receivership. Those premium adjustments themselves can also be an important funding source for the resolution plan for an LTCi writer facing liquidation.

Finally, it is conceivable that additional new capital can be secured to shore up the surplus of a company that otherwise might face liquidation. This sometimes happens in cases where the troubled insurer is a subsidiary or affiliate of another company that, for reputational reasons or otherwise, wishes to avoid the liquidation of the troubled company.

It is also possible that an outside investor might elect to infuse capital into a significantly troubled company because of a perceived opportunity to profit from the investment. Such an investor, however, would need to expect a return based on the same sources of funding available to the company

Maximizing the overall recoveries of policyholders in the insolvency of an LTCi insurer is—and should be—the goal of all LTCi resolutions

itself: the company's assets; investment earnings on those assets; and premiums (including any feasible premium increases) to be paid on policies in the future. In a company otherwise facing liquidation, those funding sources are unlikely to support an outside investor's infusion of new capital.

In theory, an outside investor might project profitable new writings in a company that it might save from liquidation. But given the various ways in which capital can be invested more easily in new writings *without* having also to assume responsibility for the accrued shortfalls of a troubled company, it is difficult to envision such investments as a plausible rescue source.

To recap, the principal funding sources for resolving and running off the LTCi liabilities of a troubled insurer are the assets of the troubled company; investment earnings on those assets; premiums that can be collected on the policies; and, if available, infusion of additional capital from an affiliated or outside investor. *If* the company enters liquidation, GAs will also provide a significant funding source for the resolution.

The losses that will be borne by LTCi policyholders in a liquidation will be, in the aggregate, roughly equal to the difference between the aggregate obligations under all of the failed carrier's insurance policies (and related costs of administration) and the aggregate funding sources for the resolution plan. LTCi obligations falling within GA statutory coverage levels will be fully protected by GAs in a liquidation, but the losses (the shortfall of funding sources compared to policy obligations) will be borne by policyholders whose claims exceed GA coverage. *Minimizing that shortfall is the primary goal of a resolution plan.*

Those net investment earnings can be a particularly important component of resolution funding, to the extent that they are intelligently managed by seasoned investment professionals, and to the extent that related expenses (including taxes) can be minimized.

Policy & Claim Administration. In any troubled-insurer resolution, effective administration of policies and claims on policies is important in satisfying the needs of insurance consumers. Administration of LTCi business is a particularly important—and challenging—aspect of the effective resolution of an LTCi insurer, for three important reasons.

First, responsive, compassionate, professional administration of claims and other policyholder needs is a central element of the LTCi insurance promise. Indeed, before financial issues for legacy LTCi became widely recognized 10 years ago or so, the highest concerns of regulators and the media regarding LTCi centered on what were sometimes perceived as unfair or inappropriate claims-handling practices by some insurers.

Second, LTCi policies inherently require more frequent and more complex interactions—over the lives of policies that may be in force for many decades—than any other form of insurance. These interactions require the engagement of an adequate force of dedicated administrative professionals with specialized expertise in LTCi.

Third, effective administration of policies and claims is a *financially* significant element of a resolution plan. This is true not only because managing direct administrative expenses reduces the overall funding needs for the resolution, but also because timely and informed input from claims administrators can both help reduce claims costs and also optimize usage of available coverage for policyholders, thus saving money both for the insurer and the policyholder.

Stakeholder Accountability. Any resolution of a troubled life or health insurer requires, first and foremost, accountability to the policyholders: They expect and deserve to receive the best possible realization on the value of their insurance contracts, as well as the service and support that the contracts promise.

A liquidation of a significant LTCi writer can require significant assessments by affected GAs to fund benefits for GA-covered obligations. (In the Penn Treaty case, those assessments were approximately $2 billion in the aggregate.) Those costs are borne directly, in the first instance, by the GA member insurers that are assessed for those costs. A significant portion of that obligation is, in turn, passed on to member company policyholders and stockholders and to taxpayers.

All of those stakeholders have a significant interest in making sure that a resolution plan effectively protects policyholders of the troubled company. For that reason, the resolution plan should be designed and executed in a way that reflects accountability to stakeholders regarding the efficiency and cost-effectiveness of the plan.

Essential Requirements of an LTCi Resolution Plan: A Recap

In order to address the problems presented by a writer of LTCi facing liquidation, several critical elements must be addressed in any effective resolution plan. The elements that must be addressed in designing a resolution plan include: (i) analyzing the costs and timing for paying policy liabilities and associated expenses; (ii) identifying and maximizing sources of funding; (iii) developing a strategy for investing funds to be held over the runoff period; (iv) developing and implementing a strategy to achieve appropriate and actuarially justified premium adjustments; (v) engaging and retaining expert resources to administer policies and claims effectively over a lengthy runoff period; and (vi) establishing mechanisms that ensure accountability to policyholders and other stakeholders.

This column attempts to summarize the resolution plan components that must be addressed in the case of a severely stressed LTCi writer. The following column will discuss, *first*, the ways in which the 50 affected state GAs worked to develop and execute such a resolution plan in the Penn Treaty case; and, *second*, the prospects for somehow improving on that outcome, if possible, through an alternative approach (a "better mousetrap"). ✯

Peter G. Gallanis is President of NOLHGA.

End Notes

1. For prior discussions in this space, see, e.g., "The Challenges of Long-Term Care Insurance," *NOLHGA Journal* Vol. XXII, No. 3 (October 2016), beginning at p. 2.
2. See, "Long-Term Care Task Force Identifies Consistent Rate Review as Key," *Best's Insurance News & Analysis*, August 5, 2019.
3. In this column, for the sake of simplicity we use "Penn Treaty" to refer collectively to the simultaneous liquidations of two affiliated companies: Penn Treaty Network America Insurance Company (PTNA) and American Network Insurance Company (ANIC). PTNA was by far the larger of the two, but the resolution challenges posed by both PTNA and ANIC were essentially similar.
4. In the case of the larger of the two Penn Treaty companies, PTNA, estate assets would be able to cover, at most, eight cents on each dollar of policyholder claims.
5. See https://www.nolhga.com/resource/code/file.cfm?ID=2515.
6. See *Modernizing Insurance Regulation* pp. 228–232 (NYU/Stern School of Business, Wiley 2014).
7. In the Penn Treaty case, a group of GA member insurance companies has asserted a challenge to the use of estate assets to pay claims not covered by GAs. The basis of the claim appears to be anomalous language of the Pennsylvania insurance receivership code, and a spokesperson for some members of the challenging group has advised the NAIC that the issues raised in the Penn Treaty case are unique to the Pennsylvania liquidation of Penn Treaty and non-standard language of pertinent Pennsylvania statutes. (See November 16, 2018, Letter of Arbor Strategies, LLC submitted to the NAIC's Receivership and Insolvency Task Force ("RITF") for discussion in conjunction with the NAIC's 2018 Fall National Meeting. A copy of the letter is included as attachment One-C to the RITF's November 2018 Meeting Materials available on the NAIC website at https://www.naic.org/meetings_events.htm.) If such a position were successful in any receivership, presumably it would also have negative financial ramifications for a "better mousetrap" approach to resolution.
8. See, "Critical Thinking in Action – Problem Insurer Resolutions," *NOLHGA Journal* Vol. XXIII, No. 3 (October 2017), beginning at p. 2.

By the time an insurer with legacy LTCi nears insolvency, it is usually not feasible to adjust premiums across the entire remaining block of business to levels that would be required to restore the insurer to normal operations.

[“Welcome to the Revolutions” continues from page 9]

Rob Negron (AXA Equitable Life Insurance Company) broke down the intricacies of New York’s cybersecurity regulation, which requires companies to perform risk assessments and develop plans to mitigate risks to data. Proper data retention rules are critical, he said; “The easiest way to protect data is not to have it.” The regulation also contains governance rules “designed to promote accountability at the highest levels of the company.”

The NAIC’s cybersecurity regulation, the Insurance Data Security Model Law, has been passed by six states so far, Negron said. The Treasury Department has recommended prompt adoption of the law in all states. If the law isn’t widely adopted in five years, he added, federal preemption “is certainly possible.”

Edwin Barkel (Lewis Roca Rothgerber Christie LLP) gave attendees a quick course on “cyber hygiene,” stressing the importance of employee training but adding that traditional training isn’t enough. Employees should be tested (some companies send fake phishing e-mails to employees to test how effective their training has been), which allows companies to identify which employees present the greatest threat to cybersecurity. Companies can also gauge their preparedness—“What would we do if a hack happened today?”—to ensure that they have the proper mitigation procedures in place. ✯

Sean M. McKenna is NOLHGA’s Director of Communications.

NOLHGA Calendar of Events

2019

December 7–10	NAIC Fall National Meeting Austin, Texas

2020

January 14–15	**MPC Meeting & GA Roundtable** **San Diego, California**
March 21–24	NAIC Spring National Meeting Phoenix, Arizona
April 15–16	**MPC Meeting** **Reston, Virginia**
July 29	**MPC Meeting** **Washington, D.C.**
July 30–31	**NOLHGA’s 28th Legal Seminar** **Washington, D.C.**
August 8–11	NAIC Summer National Meeting Minneapolis, Minnesota

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