Outlook for 2013 – Elections, Regulation and Growth

2012 has been a year of continued uncertainty in the US – for both the economy overall and the life insurance industry specifically. Regulatory developments surrounding hallmark financial-services laws (Dodd-Frank and the Affordable Care Act) are not yet clear. Life insurance sales in general remain flat, in part due to unfavorable economic conditions, and all indicators suggest that interest rates will remain low for the foreseeable future. National elections and regulatory evolution may (or may not) make a difference in economic direction and life insurance sales prospects in 2013.

Jim McArdle, Senior Vice President of Sales and Marketing, discussed possible outcomes for next year with Brian Atchinson, President of the Physician Insurers Association of America. As past Maine Superintendent of Insurance and previous president of both the NAIC and the Insurance Marketplace Standards Association (IMSA), Brian highlights the healthy tension he sees between local and national regulators, which also can help promote healthy markets. Brian earned his bachelors degree at the University of Massachusetts and his JD from Syracuse University of Law.

Jim McArdle: The national elections have some significant economic undertones for 2013. What are the top two issues that you think have the potential to most impact the life insurance industry?

Brian Atchinson: Certainly the need to address the nation’s debt and get its financial house in order will be a significant factor for almost every industry, including the insurance industry. There is really no telling to what extent the nation’s elected leaders will roll up their sleeves and come up with a reasonable way forward. I think we all hope that they can find some common ground.

Of course, from the life insurance side the hope is that the nation’s leaders do not try to change the tax treatment of life insurance in any significant way that would weaken one of the country’s most important industries and one of the most effective ways for Americans to save for the future.

Another major concern is the potential to evolve towards a one-size-fits-all regulatory structure in a nation where there are literally thousands of insurance companies – many of which only write regionally or in one or two states. Everyone knows that there’s a strong need for greater consistency and harmony among the states, and in the last few years I think we have seen significant steps taken to achieve that goal. No doubt part of this improvement came under the threat of some federal presence. But there is concern that the federal government may overdo it, that those charged with developing and implementing policy will presume that all insurance entities can be overseen just like banks, and impose a regulatory structure that may be fine for those in the banking community but terribly ill-suited for the insurance world.
JM: Discussion about the taxation of inside buildup has come up in various forms before but has not been acted on. What might be different today than in the past – different enough to actually cause some action?

BA: Well, the dynamics are somewhat different this time. With $16 trillion in national debt, it is very possible that we will see a “package approach” to resolving the federal deficit and budget shortfall. For example, this was done years ago with the military base closing commission and more recently with the Affordable Care Act, which establishes the Independent Payment Advisory Board to reduce Medicare spending. In an effort to depoliticize the issue, an independent commission essentially develops a behind-closed-doors proposal and that entire package goes to Congress for a thumbs-up or thumbs-down vote.

My concern is that the tax treatment for life insurance products could find itself a part of a Simpson-Bowles-type package deal. There may be little or no opportunity to reason with individual legislators, to engage in individual discussion and to point out the unique benefits of life insurance for millions of Americans. This makes things different from the past.

Regulatory Evolution

JM: You mentioned the risk of evolving regulations to serve one group well and other groups poorly. How in your mind could that conflict be resolved?

BA: This has been a topic that I’ve studied for a long time and it’s been fascinating to watch the evolution over the last five years or so. Dodd-Frank led to the creation of the Federal Insurance Office (FIO) and the Federal Office of Financial Research – a new office within the Treasury that accumulates and analyzes financial services data. I think these developments have been instrumental in prompting dramatic movement within the NAIC and the state regulatory system.

I served as a regulator from 1992-1997, and when I was an NAIC officer we talked about the need to harmonize and make more consistent state insurance regulation. We did make some progress, but it’s long been a truism that the state regulators move to improve what they do when threatened – usually by Congress or another federal or international body.

Since the passing of Dodd-Frank and the maturation of the International Association of Insurance Supervisors (IAIS) on the global stage, the NAIC has been moving more quickly to modernize state insurance regulation. It seems that the state insurance commissioners recognize that the FIO has the potential to move into their space, although the agency clearly has no regulatory authority.

The NAIC has been forced to move forward in dramatic ways over the last few years to bring about more consistent, predictable and harmonious regulation. I certainly would not try to defend a lot of the inconsistencies and inefficiencies and duplications in state insurance regulations, but if you look around the world, the US is not the only place with unique characteristics that make for good regulation, but that may not appear efficient or optimal to those outside.

JM: Some critics have argued pretty strongly that the tools available to state insurance regulators worked very well during the financial crisis. What are the best tools that the NAIC should be careful not to cede, even if they are not efficient, to a federal supervisory body?

BA: That’s a really good question. The NAIC has in place a series of checks and balances that serves it very well. I’m based in the Washington, DC Beltway area now and, I will say, there is a curious presumption amongst most people in this area that whatever the states are doing must be inferior. However, the performance of state regulators overseeing the trillion-dollar insurance industry was very impressive compared with the performance of some of the federal regulators during the financial crisis. The only exception involved a large insurer's international affiliate engaged in non-insurance activities and the absence of a meaningful regulator for that affiliate. The financial crisis did expose the need for enhanced coordination and cooperation among all financial regulators.

But you know the old axiom, “If you’re standing still you’re losing ground.” Just because one crisis was dealt with effectively we should not presume that the same approach will work the next time. So I believe it’s a good thing that steps are being taken within the US and internationally to ensure there is coordination among regulators regarding all of the internationally active insurance groups. These systemic improvements are a good thing. State regulators are actively involved in these efforts and are able to hold their own in these discussions, though it is sometimes an uphill climb to educate banking specialists about the unique characteristics of insurance.

I don’t see state regulation going away. I do see it evolving in a way that works, hopefully, hand-in-glove with a federal body, which looks to be the FIO and Treasury. But keep in mind that the NAIC has
about 500 staff and is complemented by the 15,000 insurance regulators and staff amongst the 50 states and Washington DC. In contrast, the FIO has about 10 employees, supported by other US Treasury staff.

The FIO is already evolving and is meaningfully participating in international forums, particularly to promote good and consistent regulation and the trade interests of the US insurance community. But it’s hard to envision the federal government assuming regulatory functions for insurance anytime in the foreseeable future. The good news is that the federal interaction and necessary collaboration is serving to really drive the states and the NAIC to enhance and improve what they are doing and how they are doing it.

I have long believed that good regulation makes for good markets. Too much regulation will kill a market. However, insufficient regulation allows disparate and disproportionate benefits in the market to flow to certain players and can hurt lots of those in the marketplace. It’s an inexact science, but good regulation is necessary for a healthy insurance market, and I think we will continue to move in that direction.

It’s a slightly awkward dance right now between the states and the federal government but it is inconceivable that the FIO, Treasury or Federal Reserve wants to handle the tens of thousands of consumer complaints that the state insurance regulators address annually. Yet if a government agency supervises the consumer and market conduct activities, it is important that that government agency be connected to the solvency and financial oversight activity because they are interrelated and need to be linked.

November Elections

**JM:** How in your opinion could the elections in November affect policy direction in 2013? Say, for example, on interest rates?

**BA:** Well, the systemic issues and problems that evolved over decades under different administrations and different political leadership will necessarily take more than just a few years to resolve. Some of the most difficult financial challenges have been met in recent years and are behind us – basically saving the financial system, saving the banking system.

Based upon what the Federal Reserve has said, it does not look like we will be seeing an increase in interest rates. While this creates challenges, it is heartening to read about insurance company management recognizing the need to make an underwriting profit. As someone who has worked on both the life/health and the property/casualty sides of the industry, I think the discussion about the importance of underwriting profits is a refreshing change from a period of time when it was not unusual for companies to rely largely upon investment earnings to reconcile the balance sheet and meet shareholder expectations. Ours is a risk management industry. It would therefore seem appropriate that companies price and underwrite to the risk, not anticipated investment spreads.

**JM:** So as for policy changes, no matter what the campaign rhetoric, you believe that the president will be working though issues as they present themselves, rather than walking in with a prepackaged solution?

**BA:** I really do. There’s a lot of political rhetoric out there, but there are a limited number of variables that the president has at his disposal. There clearly needs to be consideration to bring down the overall costs associated with Medicare, as well as other federal programs and functions. I’m sure there will be some meaningful differences in how the two parties would do that. As for revenue, both sides have made strong cases for modernizing our tax system and bringing about greater predictability and equity there. But unless one political party holds the presidency, House and a 60-plus majority in the Senate, we’ll have to have compromise. It may not be pretty, but it’s just the way our system works. Many in Washington acknowledge – off the record – that a solution based on the Simpson-Bowles approach may be the best way forward.

Consumers and Products

**JM:** We’ve discussed regulation, but I’d like to bring it down to the policyholder level. Some European regulations – for example, restricting the use of medical information, family history and gender as risk determinants – seem odd from a US perspective. Could what’s happening to underwriting in Europe eventually take hold here?

**BA:** I think we’ll know more in the next few years. The outcome will depend on whether the industry essentially self-regulates and doesn’t abuse its ability to have access to certain information. In the past we’ve seen some instances of companies getting inappropriately aggressive in terms of product design, underwriting and/or marketing – at least in the eyes of regulators. And when you have what occasionally
has been considered inappropriate activities then you will get governmental pushback through regulation. So I think the challenge for the industry is to find an appropriate level of underwriting that would not abuse that information and not unfairly discriminate against individuals while still recognizing the fact that companies are in business to make money. Every state’s insurance laws or regulation includes language basically requiring that “Rates may not be excessive, inadequate or discriminatory.”

But the US is founded on entrepreneurial spirit, and the insurance industry embodies that spirit – notwithstanding considerable government regulation. In Europe there can be different philosophical approaches towards markets and regulation.

Ultimately, public and government concerns about inappropriate behavior could move us towards some national standards in the US. On the other hand, you don’t want to tie a company’s hands behind its back and say that an insurer can’t know who it is underwriting. The life insurance industry could be disadvantaged if it cannot keep pace with modern science and information widely available to consumers.

**JM:** You mentioned companies’ past dependence on investment performance for meeting earning goals. What products offer the best opportunity for life insurers to remain relevant and profitable in the near future?

**BA:** I think that some of the blended or combination products have tremendous potential because we’ve got this enormous Baby Boom bulge coming through the demographic pipeline. Many people have moved into annuities, but a lot of people are concerned that those products may not be for them. People like the idea of long-term care insurance, but we’ve seen time and again that it’s been an extremely difficult product to price and it’s very hard for companies to make the long-term commitment. The same applies to life insurance: it’s a terrific product in many ways and for many purposes, and yet it’s sometimes viewed by folks who are not that familiar with it as kind of dated – my father had life insurance, my grandfather had life insurance... but is it still right for this and future generations?

The answer for many is “Yes.” One of the best things people can do for themselves and their families is to have life insurance, annuities and products like disability and long-term care insurance. I see the blending some of these products to meet the longevity concerns of most Americans as a great challenge – and a great opportunity.

Ironically the flip side of that is being able to produce these products in a way that they can be understood by the average Joe or Jane on the street. One of the key components of the Affordable Care Act requires that health insurance policies use the same nomenclature and terminology that includes readability standards. I think you’ll see similar types of federal edicts to try to bring that consistency to other insurance and financial products over the coming years.

As the financial security for each individual becomes increasingly their own responsibility in the future, the government may increasingly police that market segment to ensure consumers are able to make informed choices.