By Francine L. Semaya

Eye on Regulation

Will the fallout from the recession change how insurance is regulated?

The tumultuous economic events of 2008 can be expected to significantly impact the insurance regulatory world in 2009. As government reins pass to both a new president and Congress, the fundamental question of whether there should be federal regulation of insurance companies and their products will remain front and center.

Although the insurance industry was quick to assure the public of its stability as other financial institutions crumbled in the latter part of 2008, federal government bailouts throw a sharp focus on the negative impact of unregulated and under-regulated financial transactions.

Will the fallout from the recession change the focus of insurance regulation? The answer is a resounding "Yes." Here are some insurance regulatory developments we could see in 2009:

- **Credit Default Swaps:** In November 2008, the New York Insurance Department put the brakes on its full-speed-ahead effort to regulate certain types of credit default swaps as insurance. Noting that the President's Working Group on Financial Markets, the Federal Reserve Board of Governors, the SEC and the Commodity Futures Trading Commission had moved to regulate credit default swap contracts, New York Insurance Superintendent Eric Dinallo deferred to federal regulation and suspended New York's regulatory efforts. Expect Congress to introduce bills to regulate not only credit default swaps, but also similar types of investments.

- **Reinsurance Collateral:** In December 2008, the National Association of Insurance Commissioners adopted a Reinsurance Regulatory Modernization Framework proposal, dividing reinsurers into two categories: National Reinsurers, licensed and domiciled in a U.S. jurisdiction; and Port of Entry Reinsurers, non-U.S. reinsurers certified in a U.S. port of entry state to provide reinsurance to the U.S. market. The proposal calls for financial security ratings of both types of reinsurers and waives the posting of collateral for reinsurers with the highest ratings. Clearly, in today's business climate, one could question if it is the best time to reduce collateral requirements. Look out not only for NAIC's next move, but, at a minimum, federal oversight of reinsurance.

- **U.S. Treasury Department Blueprint:** In March 2008, the U.S. Treasury Department issued a far-ranging Blueprint for a Stronger Regulatory Structure, including a call for an Optional Federal Charter and an Office of National Insurance. As a creature of the outgoing Bush administration, there is serious question whether the blueprint retains any viability. The new Congress will probably focus on the ONI first. HR 5840, a bill to establish a federal office to coordinate national and international insurance policy, was pending in the House at year-end 2008.

- **Financial Stress Testing:** In November 2008, the New York Insurance Department took the lead in requiring New York domestic insurers to incorporate "scenario stress testing" into their management processes. As the department conducts on-site reviews of its domiciliary companies, it will seek plans to manage interest rate shocks, equity market shocks, yield curve shifts, changes in credit quality and liquidity, rating agency downgrades, collateral calls and large-scale catastrophes. Expect other states to follow suit with similar strategies in 2009.

Whatever shape regulatory modernization takes, change is inevitable. The question remains whether such change will be beneficial to the industry or simply place additional burdens on doing the business of insurance and reinsurance. BR

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