

HOLBORN PERSPECTIVES

LOOKING CLOSER AT...

Federal Involvement in Insurance

September 26, 2008

HOLBORN

Federal Involvement in Insurance

Overview

The U.S. Treasury advanced an \$85Bn emergency loan to AIG and may acquire an 80% shareholding. The Federal government has now become involved in the business of insurance in a large and unplanned way. Federal involvement will continue to change as Congress debates and authorizes this and other recent actions.

In a time of war and economic uncertainty with no incumbent candidate, Property and Casualty insurance issues have not been in the forefront of the presidential campaign. However, there have been debates about many insurance initiatives, including Federal charters and regulation for Property and Casualty insurers, and Federal involvement in providing capacity or more stable pricing for natural catastrophe risks. Insurance is not excluded from the general mood calling for change and reform.

After a long and wide-ranging primary season, the two major parties have held their nominating conventions. The conventions also developed the parties' platforms, which detail their respective positions on current issues and outline their new initiatives for leading the nation. This edition of Holborn Perspectives reviews the proposals in the two platforms and some others advanced by legislators, trade groups and insurers. To focus on Property and Casualty issues, we do not cover the wider debates on Health and Social Security issues. Holborn will continue to advise our clients on changes that affect their reinsurance and catastrophe-exposed coverages.

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A. Regulation and Federalism

Over 230 years as a nation, our legal approach to major business issues has swung from a federalist and state-centered approach, to a more centralized approach, and back again. In addition, we have had varying levels of government regulation of transactions between private parties. This year, as legislators addressed home foreclosures, the failures of mortgage-backed investments, contaminated food and toys, and financial distress at deregulated airlines, utilities, banks and lenders, there were already calls from both parties for stricter and national regulation to increase consumer protection. The end of all five major investment banks, at least in their previous structure, the emergency loan to AIG, and the Treasury's request for a \$700Bn pool to acquire mortgage assets, have greatly elevated issues of Federal involvement as both a regulator and a market participant.

The recent debate in Washington reflected both the extent of regulation, and whether regulation should be national or state-based. Insurance has reflected these balances. From World War II through the mid-1980's, our product has been highly regulated, especially for residential property and other personal lines, but under a state-based approach to consumer protection. Interestingly, the AIG bailout balances Treasury funding with state oversight of asset sales.

The current administration has pushed for a more centralized, but lighter degree of insurance regulation. Democrats in Congress have generally sought deeper Federal involvement in insurance, including as a market participant, with the residential mortgage-backed securities market as a model, based on Fannie Mae and Freddie Mac. This comparison has become less persuasive, as both firms have now collapsed, and contributed to the essential demise of the major investment banks.

The two parties' positions are not entirely contradictory, and in some cases, their differences are less important than specific-state issues. The result is a wide variety of bills with multiple aims. There is pressure for quick action on several proposals, including Federal regulation and the form of a renewed Federal flood program.

B. Federal Chartering and Regulation

Following the Treasury loan to AIG, Secretary Henry Paulson and some legislators in both parties called for increased Federal regulation of insurers. While that is not possible to enact in 2008, there are a variety of proposals that address that approach.

Optional Federal Charters

All states have some rate and form regulation. Some states require prior approval for rate and form changes. Other states allow insurers to change rates and forms while reserving the right to disapprove the changes. Many national companies and brokers have sought Federal regulation to streamline and reduce the cost and delay of states' rate and form regulation. Recent proposals would create parallel state and Federal systems for insurers to choose between. This approach is modeled on commercial banks, who can elect to be chartered under either state or Federal laws. The National Insurance Act (H.R. 3200, S.40) would authorize Federal charters for both insurers and producers.

The Federal approach to solvency regulation would be consistent with current NAIC model laws, but applies them through a Federal agency. The act eliminates rate and form regulation for nationally-chartered Property and Casualty insurers, and allows licensed companies and producers to trade in all states.

Introduced by Rep. Melissa Bean (D-IL) in the House of Representatives and Sen. John Sununu (R-NH) in the Senate version (S. 40), this act would establish the Office of National Insurance (ONI) within the Treasury. A Commissioner of National Insurance would regulate insurance companies and agents at the Federal level. The Commission would contain Divisions of Insurance Fraud and Consumer Affairs, and an ombudsman. Nationally-chartered insurers would still be required to participate in state guaranty associations and be liable for assessments.

The bill failed to move beyond the committee level, and is listed as "dead legislation" for this session of Congress. However, the bill has had considerable support, particularly from Life insurers. The NAIC and several insurance commissioners support the concept of an optional Federal charter, while also retaining the existing state approach.

While Nationwide, State Farm, Travelers, USAA, and Zurich and the AIA and RAA support an optional Federal charter, much of the Property and Casualty industry does not. The National Conference of Insurance Legislators ("NCOIL") has been vocal in its opposition to Federal Charters. To further complicate matters, the NAIC has expressed its support of NCOIL's position, as respects the need to preserve the current state regulatory system.

Federal charters have not yet made it to the floor, although they will be revisited in the 111th Congress regardless of the presidential election. While Federal charters may become law, it is not

certain that Congress will ease rate and form regulation for insurers that choose Federal charters, with the price of residential coverages a key concern for many legislators.

Federal Office of Insurance Information

An alternative bill, introduced by Rep. Paul Kanjorski (D-PA), (H.R. 5840) would create a new Federal Office of Insurance Information (OII) within the Department of the Treasury. The OII's purpose is to advise the President and Congress on insurance policy issues for all lines of insurance except Health. Headed by a Deputy Assistant Secretary, this office would maintain a consistent study of the insurance industry and provide counsel on international insurance issues. Although the OII would not have direct regulatory authority, it would be responsible for establishing Federal policy when state laws conflict with Federal policy on international insurance matters. In the event of a conflict, where a state law treats insurers from nations with agreements with the United States "more or less favorably" than they treat U.S. insurers, Federal policy will pre-empt the state laws. The OII's authority to resolve the conflicts makes it an implicit regulator. The meaning of "international agreements" is not clearly defined in the current bill.

The bill was unanimously approved by the House Capital Markets subcommittee on July 9th. In its approval, the subcommittee amended the bill to limit Federal pre-emption of state laws as follows:

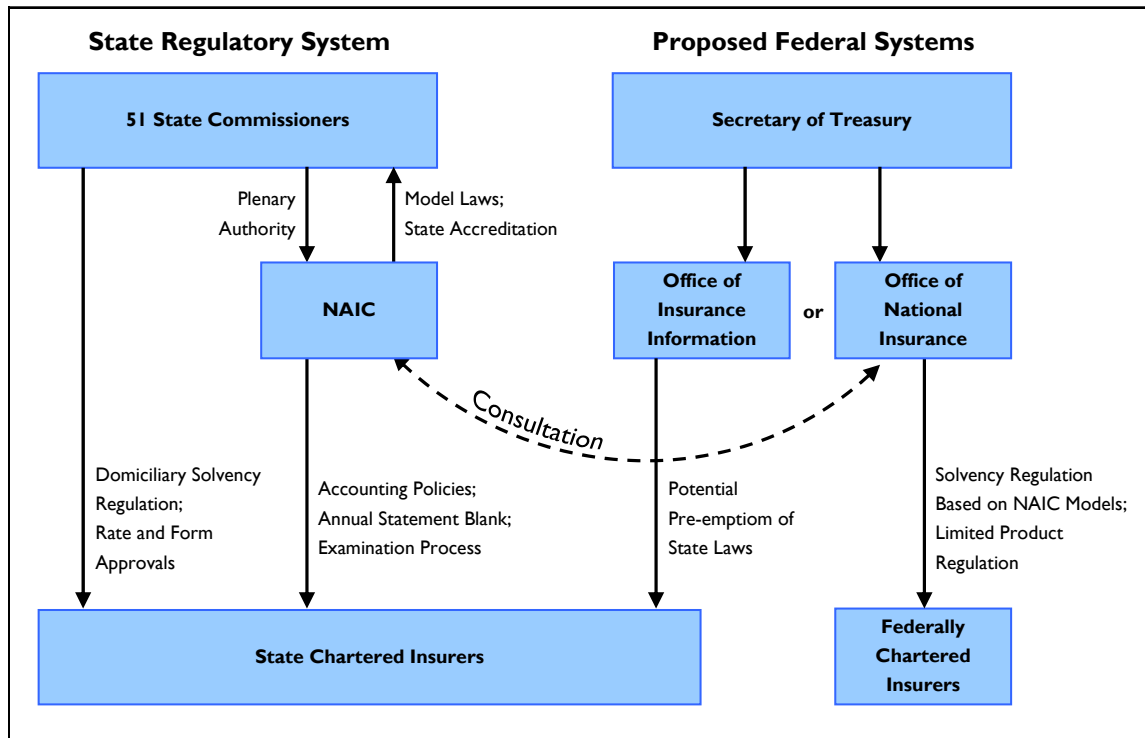
- 1) While the OII could collect data from the states, private sources and the NAIC, it would be subject to privacy and confidentiality protections;
- 2) The Secretary of the Treasury can stay a pre-emption of state authority if certain criteria are met;
- 3) There will be an administrative process for pre-emption, including judicial review;
- 4) A state legislator representative will be added to the OII's advisory group, and members will include a representative from each of the following: Life insurance, Property and Casualty insurance, reinsurance and producers.

As with optional Federal charters, there are strong proponents countered by strong opponents. The NAIC supports the OII. NCOIL stated that the current version of the bill is a "dangerous path to a Federal insurance regulator." NCOIL views the bill as overly broad because it grants the OII the ability to advise on domestic as well as international matters. The Professional Insurance Agents have mirrored that concern and have characterized it as "an overreaching power grab".

The bill was not scheduled for a vote on the House floor, and no Senate version was introduced this year. The bill will be reintroduced in the next session, and reportedly has a higher priority than Federal charters do, for many national insurers.

The potential dual approaches to regulation are shown in the following chart, with the Federal role exercised through either the OII or the ONI.

Possible Dual Approaches



National Regulation of Reinsurance and Surplus Lines

Federal regulation of reinsurance has been proposed in the past following financial distress or market price increases. Currently, it is also being driven by concerns about competition and cost inefficiencies. The Nonadmitted and Reinsurance Reform Act of 2007 (S. 929, and approved as H.R. 1065 in June, 2007) intends to streamline the regulation of non-admitted insurance and reinsurance, by applying single-state regulation and uniform standards, particularly in licensing and taxation. The bill provides that:

- Credit for reinsurance shall be determined by the ceding insurer's domicile, as long as the state is NAIC-accredited;
- Reinsurers' financial solvency shall be regulated by the state of domicile; and
- Extraterritorial (non-domiciliary) application of state law is pre-empted.

For surplus lines, the bill addresses:

- Reporting, payment, and allocation of premium taxes
- A national producer database
- Uniform standards for eligibility
- Streamlined application for commercial purchasers.

C. The National Flood Insurance Program: Refunding and Expansion

The National Flood Insurance Program provides direct insurance or reinsurance of carriers who protect residential properties in exposed areas against Flood. Property owners pay a premium, which is often subsidized. Eligibility is based both on the need for protection, and on local government preparations, including building codes. Historically, most flood claims had been along rivers, with a smaller amount due to wave action along ocean shorelines. 2005's Hurricane Katrina caused severe coastal losses, especially in Mississippi, where the strongest winds and waves occurred. But more significantly, there were tens of thousands of claims and huge losses in New Orleans where levees failed. Together, these Katrina claims exhausted the program's resources. The National Flood Insurance Act of 2004 reauthorized the Federal Flood program, but only through 2008. The House and Senate passed separate, and conflicting, reauthorization bills that will not be reconciled in this session.

More flood claims occurred in 2005 than were made in the prior 40-year history of the program. This has left the program with a debt to the Treasury that accrues one billion dollars in interest per year, and cannot be repaid as the program is currently funded.

Another concern is the dispute over flood versus wind damage which left many hurricane victims with less than full compensation, if underinsured for flood. To address this issue, the House voted to add wind coverage to the program so that claims can be adjusted without determining the cause of loss.

The most significant differences between the two versions are the House's addition of wind coverage to the program, and the Senate's proposed forgiveness of the program's \$20Bn debt. President Bush is opposed to expanding the program to include wind, as it would move the program into an area currently largely managed by private insurers. The House is balking at the debt forgiveness aspect of the Senate plan, as House rules would likely require identifying spending cuts to pay for it.

The House proposal for multi-peril coverage would allow:

	Multi-Peril		Flood Only	
	Residential	Commercial	Residential	Commercial
Structures	\$500,000	\$1,000,000	\$335,000	\$670,000
Contents and Loss of Use	\$150,000	\$750,000	\$135,000	\$750,000

Both bills emphasize actuarially sound rates, which would significantly restrict properties eligible for subsidized rates. The maximum annual rate increase would be raised to 15% from 10% per year.

There would be a broadened requirement to insure properties in “residual risk areas”, which are zones protected by levees or dams. To help ensure adequate funds for claim payments, the Senate version would require that a reserve fund equivalent to at least 1% of the limits covered during the prior fiscal year be placed on deposit with the Treasury.

To avoid the program lapsing on October 1st, Rep. Barney Frank (D-MA) introduced a six-month “as is” extension bill on September 18th.

D. National or Regional Catastrophe Pools

Introduced by Rep. Ron Klein (D-FL) on August 3, 2007 and passed by the House on November 8, 2007, the Homeowners’ Defense Act (HR 3355) establishes the National Catastrophe Risk Consortium to combine state reinsurance and residual market funds’ exposures. The Consortium would be a non-profit enterprise created and funded by the Federal government.

It would issue insurance-linked securities and purchase reinsurance to transfer these risks to the private marketplace. Neither the Consortium nor the Federal government would directly assume any underwriting risk, although credit risk exposures are less clear. Participating states would together retain all risks that are not transferred. Reinsurance contracts negotiated with the states are to have minimum attachment points at or above the 200-year loss level. The consortium can also arrange reinsurance agreements among participating states. The maximum potential liability for payment of claims under all contracts for reinsurance coverage would not exceed \$200Bn. The assumption of risk from the states and the purchase of coverage from the capital markets and traditional reinsurers would take place in a new Federal National Catastrophe Reinsurance Fund, established within the Treasury.

The program requires the Treasury to issue loans to state reinsurance programs that meet the act’s eligibility criteria. To obtain a loan, a state program must:

- Submit a report to the Treasury detailing its plan of repayment,
- Obtain the Treasury Secretary’s approval of the report, and
- Be unable to “access capital in the private market at a commercially reasonable rate.”

Liquidity loans will be priced at three percentage points above Treasury notes and have a maturity between five and ten years. (Apparently, Berkshire Hathaway’s recent liquidity facility for Florida’s Cat Fund would not be “commercially reasonable” with a return of over five points above LIBOR.) Post-loss “catastrophic loans” will be priced at 20 basis points above the equivalent Treasury bonds. Moreover, catastrophic loans will have a term of at least ten years, with no limit on the maximum term. Treasury is instructed to “require the full repayment of all loans made,” but the Secretary can also simply report to Congress if any loans are “likely not to be” repaid.

The Southern Governors' Association, including eight Republicans, have supported the proposal. Several prominent Homeowners carriers have similar Cat Pool proposals, which would reduce their needs for Property Catastrophe coverage.

Although this proposal is intended only to pool and not to subsidize risk, there were similar intentions in the original terms for the Flood program, Unemployment Insurance and the Medicare prescription drug benefit. Each program has now received of many billions of dollars of tax payer subsidies.

Various insurers, including Allstate, Hartford, Nationwide, State Farm and Travelers have made their own proposals that include some form of pooling, while attempting to preserve a private market for property coverage in catastrophe-prone areas. They have taken different approaches to the roles of the states and Federal government, and whether coverage is optional or mandatory.

The Travelers and Nationwide Plan

Travelers, together with Nationwide, the Independent Insurance Agents and Brokers of America (IIAB, or the Big I), and the Council of Insurance Agents and Brokers (CIAB) support a plan to address the availability and affordability of coastal wind insurance. The group proposes a "Four Pillars" Coastal Wind Zone Plan, which is intended to provide windstorm coverage for coastal policyholders along the Gulf and Atlantic coasts, without relying on taxpayer subsidy. Most importantly, those living outside the coastal zones would not subsidize losses for windstorm-exposed policyholders.

- 1) **Regulatory Stability** – Create four zones: Gulf, Florida, Southeast, and Northeast. Establish Federal oversight for named-storm coverage and allow states to regulate other perils. Insurers would be able to spread the cost of risk among different zones, reduce the reliance on residual markets and improve the availability of private insurance.
- 2) **Rating Transparency** – Use generally accepted standards and catastrophe models to set actuarially sound rates in a transparent manner. Rates to be filed with a Federal board. Should model expectations and actual experience differ over time, premium credits will be available. Transparency should alleviate the concern that insurers are taking advantage of policyholders as well as ensure payment of losses through appropriate risk-based pricing.
- 3) **Federal Reinsurance Mechanism for Extreme Events** – Federal reinsurance would be funded by actuarial-based rates (without government subsidy) paid by insurers. Any savings from the reduced cost of reinsurance for extreme events will be passed directly to the policyholder. The Federal board would have the ability to adjust the reinsurance level according to storm activity and market need. Coverage would be available for losses from multiple events in a single season.

- 4) **Stronger Homes to Withstand Severe Wind** – Enforce strict building codes and land-use guidelines through adoption incentives. Provide policyholder premium credits for protecting or retrofitting homes, as well as consideration for state and local tax incentives. The enforcement of stronger homes will prevent larger losses, in addition to keeping down the cost of insurance.

The Hartford Plan

In August, 2008, the Hartford announced its own proposal for stabilizing the coastal Homeowners market. Hartford's proposal is based on:

- 1) **Sensible Land Use Planning** – Recognize the risk factor and cost of insuring homes on the coast. Enforce strict building codes and control development of coastal land. Provide incentive to homeowners to mitigate risk to wind damage by installing storm shutters or other preventative measures.
- 2) **Expand Private Market** – Use regulation to ensure the cost of insurance matches the risk insured in order to attract capital. The goal is to encourage market discipline to stabilize private insurers and keep FAIR plans as a true last resort.
- 3) **Strengthen State-sponsored Insurers** – Require state-sponsored insurers to use risk-based pricing and adequate capital in order to alleviate the burdens on tax payers and other policyholders.
- 4) **Federal Backstop Only for Extreme Events** – In order to encourage the private market to write business in coastally-exposed regions, a Federal program would prevent state and local sectors from growing beyond their means. It would also protect private insurers against high severity, low frequency events. The benchmark would be a 1-in-100 year event, but could be adjusted upward.
- 5) **Reaffirmation of Policy Language** – When faced with losses, stand by the legitimacy of state-regulated language, which will reinforce contract integrity.
- 6) **Financial Assistance** for families and retirees, funded by states. Create an IRA-like savings vehicle for those who may be burdened by cost of insurance, also propose means-tested subsidies to be administered at the state level, separate from insurance.

The Hartford proposes that states create their own reinsurance funds to be regulated by the Federal government. These funds could be accessed by private and state-sponsored insurers in the event the capacity of the private market significantly diminishes to (tentatively) a 1-in-50 year loss. The cost of state reinsurance would be listed separately on policy statements and all cost would be passed directly through to the policyholders.

If a state is decertified by the Federal regulatory authority, state withdrawal from the Federal program or termination of the program, the Federal backstop would only cover existing policies until their expiration.

The State Farm and Allstate Plan

State Farm and Allstate sit on the other side of the argument for regulation of coastal properties. These two giants argue that events greater than Katrina are too big for traditional insurers. They propose that the states set up funds to sell low-cost reinsurance to insurers operating in the state, with any savings passed on to policyholders. The Federal government would then step in after a major catastrophe and help absorb the cost of claims payments. In order to properly capitalize and pay losses, the two companies say they would need to increase rates or reduce coverage without government assistance.

The State Farm and Allstate proposal has two parts:

- 1) A central fund would be established on the Federal level in addition to state funds through insurance pools. Homeowners insurance would include a surcharge to be paid to the state's fund, which would then be sent to the Federal level. After a large event, insurers would be responsible for the first several millions of claims payments. In excess of this level, the state funds would pay a share of the costs.
- 2) At another pre-determined level, each state could receive money from the Federal fund, which would have authority to issue hurricane coverage bonds, backed by the Federal government.

E. Other Catastrophe Proposals

Catastrophe Reserves

U.S. insurers cannot establish reserves before an event occurs. Following Hurricanes Andrew in 1992 and Katrina in 2005, the market disruption led to suggestions that insurers should establish (and deduct from their taxes) reserves for future catastrophes. Tax Deferred Catastrophe Reserves (TDCRs) would allow primary insurers to treat future catastrophe losses much like IBNR for tax and solvency regulation purposes. They would be allowed to deduct these reserves, creating a current-year tax deferral. Taxes would be paid on withdrawal from the reserve as income, for non-cat purposes, and may or may not be taxed as income if used for catastrophe losses, depending on the proposal. The sponsors' goal is not to replace the current reinsurance relationship, but to add additional capacity.

The idea was introduced in the United States in the mid-1990s. Though these reserves are popular, and sometimes mandatory, in Europe, Japan and Puerto Rico, where they are sometimes referred to as "equalization reserves", they have not received the necessary support to be enacted as Federal law in the U.S. In Europe, equalization reserves will not be recognized under the new International Financial Reporting Standard (IFRS), although they could remain tax deductible under national laws.

The main objectives of TDCRs are to:

- 1) Continue property development in catastrophe-prone areas;
- 2) Strengthen the ability of disaster-stricken areas to recover quickly and completely and;
- 3) Reduce the long-term dependence on Federal assistance after events.

TDCRs promise these effects through:

- 1) Increased capacity for catastrophe insurance;
- 2) Reduced cost to policyholders, which would encourage more homeowners to be insured or more fully insured and;
- 3) Reduced risk of insurer insolvency.

The NAIC, developed its own, competing proposal, authorizing insurers to create and report these reserves. Although without Federal tax deductibility there is little reason for them. Legislation has been introduced in the 107th Congress (H.R. 785), the 108th Congress (H.R. 4186) and again in the

109th Congress (H.R. 2668) which would deduct contributions to TDCRs from taxable income. The current Congress has introduced legislation in both the House and the Senate (H.R. 164 and S.926). In early 2007, these bills were referred to the House Committee on Ways and Means and the Senate Committee on Finance. No further official action has been taken.

Catastrophe capacity would grow because funding losses would now be less expensive for insurers, with interest earned on these reserves compounding at pre-tax rates. Proponents also believe that tax deferral would reduce insurers' cost of capital while having no effect on their investors' required return. The difference between the cost of capital and required return would be passed on to consumers through a competitive marketplace. On a simpler level, it is difficult for insurers to fund a 100-year loss, when tax losses can only be carried forward for twenty years.

Critics wonder whether TDCRs would have the intended results. Some argue that the loss of Federal taxes would be more than the cost of direct Federal intervention in the long-term. Cat reserves may compete with, rather than complement, traditional and other types of reinsurance, and so offer no additional net capacity. Additionally, depending on the details of the legislation, these reserves may simply offer a tax deferral for non-catastrophe business. A very real practical concern for legislators in the budget deficit era is that TDCRs would reduce Federal tax receipts. Few politicians want to be seen as giving "a handout" to insurance companies. Passing Federal legislation will be difficult, as seen in the past decade's inability to achieve this and the politically difficult task of reducing tax revenue.

Certainly, there are many who support enacting legislation. The idea has the backing of some insurers, notably USAA, and several state regulators. Florida Insurance Commissioner Kevin McCarty advocated (in 2008) a tax deduction for disaster reserves. In October, 2007, NY Superintendent Dinallo proposed a new regulation (number 189) that would establish mandatory catastrophe resources, without tax deductions. Insurers would contribute into the reserves the amount of catastrophe loads included in their direct premiums, and hold that amount for 20 years, except as required to pay catastrophe losses. The proposal addresses NY natural catastrophe exposures, but not terrorism, for all insurers, regardless of domicile. Reinsurance would be excluded.

F. Issues Likely Deferred After 2009

Restrictions on Uses of Credit Scoring

Personal lines insurers often use insureds' credit histories or related financial information to underwrite and price business. State regulators have taken varying actions, ranging from forbidding the practices, to requiring increased disclosure. The strictest responses have often come in states that already limit the use of demographic information in automobile rating. More laissez-faire states have accepted the practices as increasing the amount of competition in the market. Some legislators have called for new Federal law to further restrict the use of this information.

Expansion of Risk Retention Groups

Risk Retention Groups are insurers, and Risk Purchasing Groups are buying cooperatives, authorized under Federal law, and are only subject to an abbreviated form of state regulation. Membership is restricted to a group of similarly-exposed operations, with a common interest in protecting their insurance exposures. Congress authorized Risk Retention Groups and Risk Purchasing Groups in 1986, following an extremely hard liability market (Products liability risk retention groups had already been authorized in 1981). Following the 2004 and 2005 hurricanes, and the difficulties in purchasing property insurance that have been reported, some groups have called for authorizing Risk Retention Groups to also write Property coverages.

Further Expansions of TRIA

Under the 2007 expansion of TRIA, the Treasury is required to study the adequacy of protection for nuclear, biological, chemical and radiological attacks, and the need for protection of Group Life coverage. That extension was passed in a long and tough negotiation between the House and Senate. Sen. Shelby was able to restrict some of the expansions in the Senate version, while Rep. Frank, Chairman of the House Committee, was able to broaden a variety of features in the House version, including increasing the limit, requiring mandatory offer of NBCR coverage (preventing exclusions for radioactive contamination, mold etc.) and adding a parallel program for Group Life. In the final days of the session, the Senate version prevailed. However, Rep. Frank committed to revisiting these issues in the next Congress.

Anti-Trust Repeal

In the early days of insurance in the United States, small single-state mutuals were the most common form of company, and regulation, if any, was based in each company's local state or even city. Over time, larger insurance companies (often stock) expanded across state lines, leading to the formation of the NAIC in 1871 to coordinate the work of individual states and strengthen solvency standards.

Congress and the Federal courts generally deferred to the states on insurance, and while Federal authority is clear, Congress has deliberately relied on the state system. The debate about eliminating the exemption goes back to the 1980s when industry rate bureaus were accused of anti-competitive action as part of the hard liability market. At that time, a variety of people had called for repeal, including consumer groups and some members of NCOIL.

In 1945, Congress passed the McCarran-Ferguson Act which reserved insurance regulatory and taxing authority to the states. Under McCarran-Ferguson, "No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or a tax upon such business." Subject to limited conditions, McCarran-Ferguson also gave insurance companies limited exemption from Federal anti-trust laws, enabling insurers to pool data and share rules and forms, profoundly shaping the nature of the business, even today.

On Feb. 15, 2007 Senate Judiciary Committee Chairman Patrick Leahy (D-VT), Ranking Member Arlen Specter (R-PA), Majority Leader Harry Reid (D-NV) Minority Leader Trent Lott (R-MS), and Mary Landrieu, (D-LA), introduced S. 618, the Insurance Industry Competition Act of 2007. The legislation would amend the McCarran-Ferguson Act to permit the Federal Trade Commission and the Department of Justice to enforce federal antitrust laws and regulations. The legislation would leave it to the FTC and the DOJ whether to issue joint statements of their antitrust enforcement policies in the business of insurance, replacing more than a half century of these policies by the states.

Identical legislation (H.R. 1081) was introduced in the House of Representatives by Representatives Peter DeFazio (D-OR), Gene Taylor (D-MS), Bobby Jindal (R-LA), Charlie Melancon (D-LA), Rodney Alexander (R-LA) and Walter Jones (R-NC).

On April 3, after three years of hearings, the Antitrust Modernization Commission issued its Report and Recommendations. Although the report did not call for an outright repeal, it did recommend that McCarran-Ferguson should be further reviewed by the Congress.

Under the proposals for Federal charters, much of the current anti-trust exemptions for the Property and Casualty insurance industry would be eliminated.

G. Appendices

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- Appendix 2** Treasury Department “Regulatory Blueprint”
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I. Positions of the Presidential Campaigns

“I think that we need a national catastrophe fund.”

-Sen. Obama, May, 2008

“We will develop a National Catastrophic Insurance Fund to offer an affordable insurance mechanism for high-risk catastrophes that no single private insurer can cost by itself for fear of bankruptcy.”

- Democrat 2008 Platform

“I do not support a national catastrophic insurance fund.

-Sen. McCain, January, 2008

“The Federal government's system for responding to a natural calamity needs a radical overhaul. We recognize the need for a natural disaster insurance policy.”

- Republican 2008 Platform

With discussion of war, mortgages, recession, taxes and abortion, insurance issues have largely not been discussed by the campaigns, except for this one consumer “pocket book” issue. In recent days, both campaign have suggested increased regulations of financial institutions, and that will shape the debates on insurance in Congress next year.

In an interview with the Palm Beach Post, Senator Obama expressed his support of a national catastrophe fund. However, he qualified this, saying “the key is to make sure that it’s run efficiently, that it’s adequately funded, and that we build in smart incentives to assure that developers are mitigating risk when they’re making decisions on where to locate homes or businesses.” He estimates that a fund could save \$11.6Bn in annual Homeowners premiums, apparently by eliminating the private market’s risk and expense charges.

As has been the Republican nominee’s fashion on numerous issues throughout his career, Sen. McCain has had few, but unambiguous words (and at variance with some in his party), relating to the insurance industry. He was quoted as opposing a Federal pool in the days immediately before the Florida Republican primary. Only a few days into the hurricane season, on June 5th, 2008, McCain’s camp issued the following statement: “John McCain is opposed to a government-run National Catastrophe Fund, not because he doesn’t have serious concerns about the cost of insurance in Florida, but because it ignores the need for private insurance reforms to broaden markets and protections against the cherry-picking of individual states.” It would appear that the potential cost of a NCIF is not his only objection, Sen. McCain also appears put off by distorting a free market. But, despite their candidates’ position, the final platform voted by the Republicans in Minneapolis actually favors pools.

Not surprisingly, the Democratic nominee has a position on national catastrophic funding diametrically opposed to that of the Republican nominees. Also, not surprisingly, both campaigns are using this issue as a way to attack each other.

2. Treasury Department “Regulatory Blueprint”

On March 31, Sec. Paulson listed a series of short and intermediate-term recommendations to improve the U.S. financial regulatory structure, including for insurance. The short-term recommendations focus on taking action to improve regulatory coordination and oversight, after early signs of distress in the credit and mortgage markets. The intermediate recommendations would eliminate some duplication in U.S. regulation, but more critically, seek to improve the regulatory structure in the financial services industry, through a “more modern” approach that will increase U.S. competitiveness. While the blueprint raised the profile of some issues, it has now largely been passed by, with more urgent approaches implemented with little discussion.

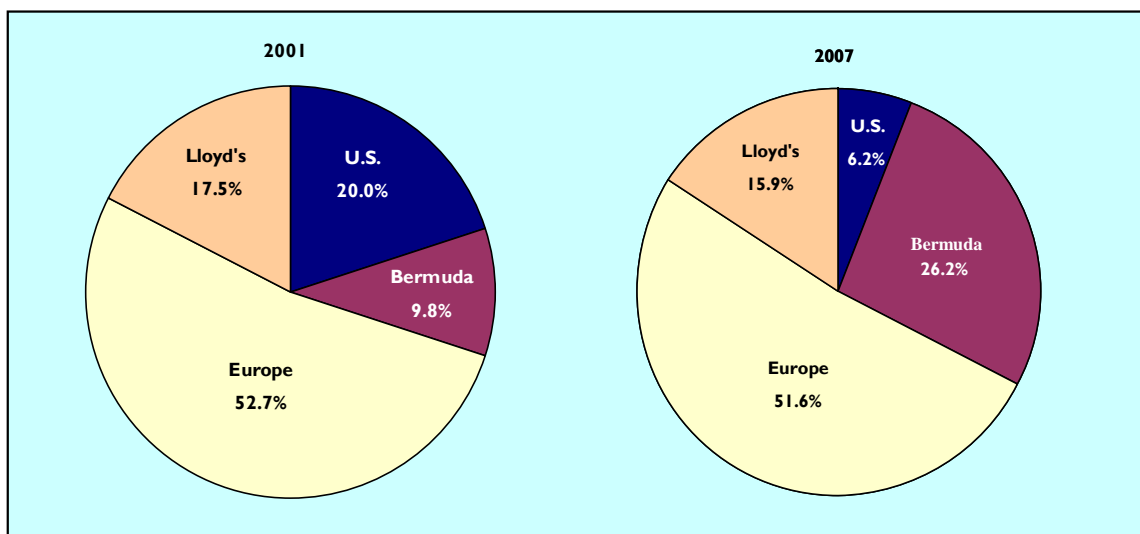
The regulatory framework for all financial institutions was developed many years ago. In some cases, such as commercial banking, there are cooperative arrangements between Federal and state offices, while in other cases, tensions remain about state authority. In contrast, futures are regulated solely at the Federal level. States had regulated insurance with only limited Federal involvement for over 135 years, but that is no longer true in late 2008.

The overall regulatory structure served the United States well for decades, and the U.S. maintained a leadership position for financial institutions. However, the U.S. financial markets have recently been losing share, perhaps due to:

- Sarbanes-Oxley and other increasing regulations in the U.S.;
- The maturing foreign financial markets and their ability to provide deep and liquid sources of capital; and
- Financial innovation in more efficient and modern regulatory systems elsewhere.

These developments are encouraging business to move to jurisdictions with more efficient regulation, such as London (for investment banks) and Bermuda (for reinsurers). Sec. Paulson believes that if nothing changes, the regulatory structure would inhibit the continued growth of the U.S. financial services industry and the economy as a whole. This trend away from the U.S. is clear in the reinsurance market.

Reinsurance Industry Premiums by Domicile



Source: Holborn Study.

Treasury's blueprint recommends Optional Federal Charters issued by a newly established Office of National Insurance (ONI), but that in the short-term, Congress first create a national Office of Insurance Oversight (OIO) within Treasury, which could be rolled into the ONI, once passed. The OIO would focus immediately on key areas of Federal interest, but not yet require the creation of a Federal regulatory structure. The OIO would exercise new statutory authority to deal with international regulatory issues, such as reinsurance collateral, as proposed for the OII, under H.R. 5840.

3. 2008 Congressional Actions

Congress has focused on the increased cost of residential insurance in high-risk areas, as well as the dramatic losses experienced by both private insurers and assistance payment by FEMA from hurricane Katrina. Democratic legislators favor increased government involvement to reduce costs for consumers. Democrats introduced legislation in order to lower consumers' costs by allowing state reinsurance programs to pool their resources at the national level, with Federal or securitized market support. "The devastation of the last couple of hurricanes has changed things," said Rep. Frank. "the experience has changed a lot of people's minds." Support for Federal Support has been strongest from Florida Representatives, such as co-sponsors Ron Klein (D) and Tim Mahoney (D).

The Senate was more reluctant to pass these bills. The Senate Banking Committee, under Chairman Sen. Chris Dodd (D-CT), introduced parallel legislation with similar wording to House bills, but there has not been support to bring these forward under the Senate's cloture rules to end debate and vote. Sen. Shelby has resisted or moderated most efforts to expand Federal involvement in insurance markets.

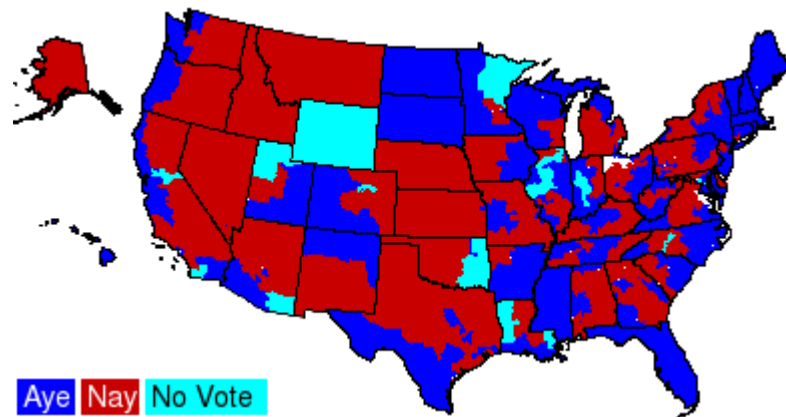
Republicans, with some exceptions, view this legislation cautiously. Attempts to create a national catastrophe fund or to require the Federal Flood program to offer wind coverage have been seen as excessive interference with the private market. Votes have split largely on party lines.

One area where Republicans displayed interest is in Federal charters. Rep. Spencer Bachus (R-AL), ranking member of the House Financial Services Committee, has supported the National Insurance Act, while Senate Banking ranking member Sen. Shelby held hearings.

H.R. 3355: Homeowners' Defense Act of 2007

This legislation passed the House of Representatives with a vote of 258 to 155 on November 8, 2007. The votes were cast primarily on party lines with 98% of Democrats supporting and 80% of Republicans opposing. All Florida Republicans voted for the legislation. The Senate equivalent of the Act (S. 2310) was introduced by Sen. Hillary Clinton (D-NY) on November 6, 2007.

	Total	Democrat	Republican
Ayes:	258 (60%)	219	39
Nays:	155 (36%)	3	152
No vote	19(4%)	10	9

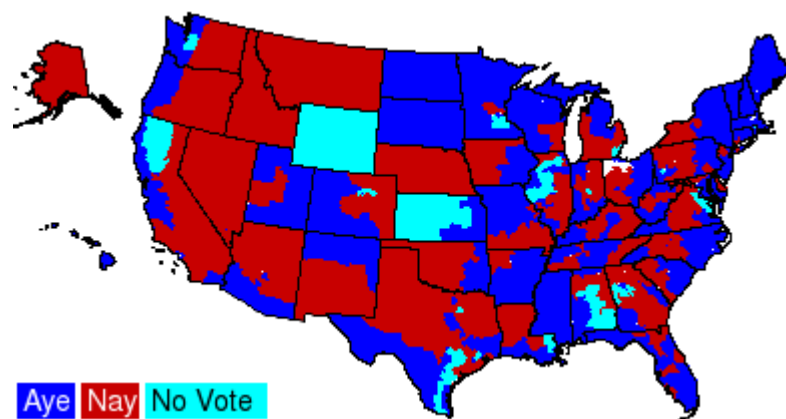


Source: www.govtrack.us

H.R. 3121: Flood Insurance Reform and Modernization Act of 2008

Introduced by Rep. Maxine Waters (D-CA) with numerous co-sponsors, this Act extends the National Flood Insurance Program through to fiscal year 2013, increases the size of limits available, and offers multi-peril coverage for the first time. The act passed the House 385 to 26 with 23 Representatives not voting.

	Total	Democrat	Republican
Ayes:	263 (61%)	218	45
Nayes:	146 (34%)	1	145
No vote	23 (5%)	12	11



The Senate results were significantly different with a greater number of Republicans voting for this legislation. Given the significant increase in potential liability to the Federal government from the addition of wind coverage, the large number of Republicans supporting the legislation is surprising.

	Total	Democrat	Republican	Independent
Ayes:	92	45	45	2
Nayes:	6	4	2	0
No vote:	2	0	2	0

H.R. 1065: Nonadmitted and Reinsurance Reform Act of 2007

Sponsored by Rep. Dennis Moore (D-KS), this Act passed the House June 25, 2007. Its Senate equivalent (S.29) was introduced by Sen. Mel Martinez (R-FL). This Act allows non-admitted insurers to choose a single state for regulation. Similarly, reinsurance credit cannot be denied if the reinsurer is regulated by an NAIC state or a domicile with comparable financial solvency requirements.

4. Positions Taken by Trade Groups

Issues	PCI	AIA	RAA	NAMIC	IIAB	ACLI	CFA
Office of Ins. Information	Propose Changes	Favor	Favor	Favor	Favor	Favor	Oppose
Optional Federal Charters	Oppose	Favor	Favor	Oppose	Oppose	Favor	Oppose
Flood Program Refunding	Favor	Favor	Favor	Favor	Favor	Silent	Favor
Wind in Flood Program	Oppose	Oppose	Oppose	Oppose	Oppose	Silent	Favor
National Cat Pools	Oppose	Oppose	Oppose	Oppose	Favor	Silent	Oppose
Anti-Trust Repeal	Oppose	Favor	Favor	Oppose	Oppose	Favor	Favor
Expansion of TRIA	Favor	Favor	Favor	Favor	Favor	Favor	Oppose

5. Industry Support for Federal Charters

The Optional Federal Charter Coalition was formed in August, 2007. The current members are:

- Agents for Change
- American Bankers Association
- American Bankers Insurance Association

- American Council of Life Insurers (ACLI)
- American Insurance Association
- Association for Advanced Life Underwriting
- Business Roundtable
- The Council of Insurance Agents and Brokers
- The Financial Services Forum
- The Financial Services Roundtable
- Life Insurers Council (a council of LOMA)
- The National Association of Independent Life Brokerage Agencies
- Reinsurance Association of America (RAA)

6. Legislative Calendar for the 111th Congress

September 8th to September 26th, 2008: The current Congress returned after its August recess and the conventions. Since no spending bills have been passed and the new Federal fiscal year begins October 1st, the remaining priorities are to authorize the mortgage assistance plan requested by Sec. Paulson and to pass Continuing Resolutions to prevent government shut-downs. Little other substantive work is planned before members return home to campaign.

In addition to electing our 44th president and the new vice president on **November 4th**, we will elect all House seats and one-third of the Senate. This will begin a period of re-organization of committees and staff for the incoming 111th Congress. The next Congress will address business carried over from the current Congress, including the overdue Federal budget, and consider the initiatives of the winning presidential campaign and his executive and judicial nominations. The key dates for legislation are:

November 5th: Newly elected members begin to hire staff. Congressional leadership begins to re-assign committee memberships. There will be significant changes in committee memberships and staffs, if there is a large increase in the Democrats' majorities, as is expected.

Late November or Early December: Either the congressional leadership or (less likely) President Bush may call Congress back for a "lame duck" session, which would continue with the current members and committees, even those who retired or were defeated. At the end of 2008, the 110th Congress's bills, nominations and committee reports expire, and will need to be taken up by the next Congress.

January 6th, 2009: The new Congress convenes and begins with the procedural work of organizing committees and staff. Members reintroduce their "pet" bills. The incoming President formally nominates all key executive appointments, and pushes for any "first hundred days" programs.

January 20th: Inauguration day, the Senate's business will move toward confirmation hearings.

Later in the First Quarter: The overdue 2008 spending bills will be negotiated, and Congress begins to discuss the new President's program.

Mid-year 2009: Congress and committees begin to discuss other initiatives carried over from the prior Congress.

September to November, 2009: A working period between the August and Thanksgiving recesses. Spending bills for 2010 should be addressed now.

Mid-December, 2009: A short working session when critical bills tied to the year-end will be addressed.

Late January, 2010: The President's State of the Union address which will re-emphasize his campaign priorities and introduce new initiatives.

Balance of 2010: As an election year, members focus their work on the most current issues, with attention to their and their parties' re-election. Summer breaks will be extensive as members return home to campaign.

November 2, 2010: Congressional mid-term elections. Unofficial start of the 2012 presidential primary campaigns.

7. For More Information

Holborn Contacts

Many staff department and broker officers at Holborn contributed to this edition of Holborn Perspectives, including: Kael Coleman, Geoff Farrow, Weatherly Hammond, Paul Kneuer, Paul Little, Rochelle Loskywitz, Garry Perkins, Scott Rosenthal, Jessica Turturro and Kathy Sandberg.

Holborn published another recent whitepaper on credit market troubles and their effect on reinsurance markets. Please contact Holborn at 212-797-2285 or visit our website at www.holborn.com for more information or for reprints on these or previous Holborn Perspectives whitepapers.

About Holborn

Holborn is an independent reinsurance brokerage firm, offering advanced analytic tools, global market access and responsive account services to clients across the United States. The company was formed in 1920, making us one of the most experienced reinsurance brokers in the world. We are owned

exclusively by our employees. This contributes to Holborn's stable client base and noteworthy ability to attract and retain talent.

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