



On August 9, 2011, SCOR SE, a global reinsurer with offices in more than 31 countries, acquired substantially all of the life reinsurance business, operations and staff of Transamerica Reinsurance, the life reinsurance division of the AEGON companies. The business of Transamerica Reinsurance will now be conducted through the SCOR Global Life companies, and Transamerica Reinsurance is no longer affiliated with the AEGON companies.

While articles, treaties and some historic materials may continue to bear the name Transamerica, AEGON is no longer producing new reinsurance business

The Forecaster

Financial Reform Outlook: Will Insurers Help Drive Policy?



By Paul Rutledge, III,
FSA, MAAA,
President

The financial services industry is experiencing a level of change not seen in a long time. In addition to the recently passed Dodd-Frank bill, banks and insurers face accounting and regulatory changes that have implications which today remain unclear.

Gene Ludwig, Founder and CEO of the Promontory Financial Group, shares his outlook with Paul Rutledge, president of Transamerica Reinsurance. Gene believes the insurance industry confronts some notable challenges, but is optimistic about the industry's ability to influence policy direction through the new Federal Insurance Office.

Before establishing the Promontory Financial Group, Gene was Vice Chairman and Senior Control Officer at Bankers Trust/Deutsche Bank. He also served as Comptroller of the Currency during the Clinton Administration. Gene coauthored The Proposed Office of National Insurance: Organization, Functions, Size and Cost, an in-depth report on federal-level regulation sponsored by the American Council of Life Insurers, the American Insurance Association and the Financial Services Roundtable. He is a graduate of Haverford College and an Oxford Scholar. Gene earned his LLB from Yale University, where he also served as editor of the Yale Law Journal.



By Eugene Ludwig,
Founder and CEO,
Promontory Financial Group

Paul Rutledge: When you go through the recent financial reform legislation, it's hard to tell how the federal government views the insurance industry in terms of public policy and systemic risk issues. There's very little recognition of the insurance industry at all.

Gene Ludwig: The insurance industry, it seems to me, is lucky in that it gets less federal policy focus than banking. Part of this is earned because there have been few problems compared to the banking industry over the last couple of decades. And part of it is serendipity. When you drive into a small town, like my hometown of York, PA, a Greek-columned building dominates the square. It's the bank. You don't see the insurance companies. So when problems arise in the financial sector, official Washington and unofficial America tend to think "banks." As a result, all kinds of financial issues – hedge fund issues, private equity issues – get swept up under the notion of "the banks."

PR: Part of it, in my mind, is that insurance companies are viewed as long-term kinds of business with long-term risk profiles. The current solvency and accounting regimes have been set up to protect that. Banks are just the opposite. They're about liquidity and balance sheets and mark-to-market. There's not a lot of leeway in terms of accounting over time horizons and through volatility in the markets.

But it looks to me like these forces are changing for the insurance industry, and we're moving very much to a mark-to-market solvency regime. Again, from a federal perspective, I don't see a public policy view of these issues, and what it means for the insurance industry to be placed, potentially, within the same framework as the banking industry.

GL: That's a very astute comment. I don't think the general public – and I mean even the highly informed and influential public, if they're not in finance – fully understands the difference between the long-dated liabilities of insurance versus the volatility of banking

due to the mismatch and leverage inherent in that business. Because this difference is less understood, I think the accounting profession on the one hand and some policy makers on the other hand could lump together banking and insurance for accounting and regulatory purposes. As an aside, for both banks and insurance companies, it would be a mistake to fail to recognize the nature of some assets that simply cannot be valued on a mark-to-market basis.

FIO: What's Expected of It?

PR: That leads us right to the Federal Insurance Office (FIO), which was one of the things that did come out of the financial reform. To me, it has a pretty vague charge. From your perspective, what is the intended role of the FIO?

GL: First, I think the FIO is a nod to those larger insurance companies that wanted federal regulation but couldn't get there. Second, it's also a recognition that multiline or multi-product insurance companies like AIG could be systemically significant, and there probably ought to be a federal entity with a better understanding of the nature of insurance. Third, I think several people in the Administration and in Congress understand that a federal insurance agency can more naturally address international regulatory issues in a way that state agencies have not been able to do.

Now the office itself, as you imply, is awkward. It's not a regulator. It's in the Treasury. It's not clear whether it will be half a loaf of just a slice of toast.

PR: Or just another regulator in an already crowded field. The thing that concerns me – and you just brought it up – is that the FIO is part of the Treasury. Looking at Basel II and Solvency II, it seems that federal oversight groups get tangled up when they view financial services as one sector. They start with banking regulations. From there they look at the biggest insurers, which are mostly property-casualty insurers with liabilities that are

more akin to banking. And only then do they get to life insurance. You run the risk of oversimplification and having the larger bodies force rules down the chain of insurers, and it's just not conducive to the market.

GL: The failure to adequately differentiate between the needs of the small and large is a big issue that international bodies tend to lose sight of. Outside of the United States, by and large, you have big companies or no companies in the financial services sector. So your worries are genuine.

As far as the FIO is concerned, whether the risk becomes a danger and the danger becomes a problem depends, it seems, on how the insurance industry deals with policy issues and helps to shape the new office. The FIO can be a win-win opportunity – offering a better public policy focus and explaining industry complexity while it serves the country's interests.

I'm a big believer that policy can be formed in the crucible of intellectual thought if people who have a point of view express it vigorously and carefully. In most cases, I'm sorry to say, they don't. They view Washington simply as someplace you lobby, not a place that deals with public policy issues in a more complex way. There is a very good chance, if one works with it, that the FIO could actually be a valuable voice on insurance issues in the policy formulation exercise in Washington.

PR: In today's environment, given the economy and all the other problems, how long do you think it's going to be before the FIO is up and running and able to get Congress' attention to make a statement around policy and industry needs?

GL: Meaningfully, a year to five years, depending on circumstances and people. Here's what I mean: if there's a big insurance problem, it gets up quicker. If the person appointed to head it is a firecracker, it gets going quicker. If neither of these is the case, it won't be forever but it may be three years. If at the end of three years the office is not up and operating, I think the Administration gets heavily criticized. There will be some juices flowing within the

next few months but in terms of having a meaningful impact on the debate, it really depends on circumstances and the people.

Future Role of the States

PR: How do you see the role of the NAIC evolving? Do you see it becoming more of a lobbying group for state regulators on the federal level?

GL: The country has always leaned toward federation – a dual system of state/federal regulation. In banking, that dual system has been a see-saw for 150 years. There's a tilt to more federal-level involvement, but there's still a genuine state component to it. I think this see-saw will be reflected in the insurance industry as well. The lobby of state bank supervisors is more active in Washington than the NAIC historically has been, and I expect the NAIC will adopt a similar role.

The country is so constructed on a federation model that some state component will be part of the landscape for quite a long time if not forever. I would say that in the insurance area, it will be real for a very long period of time.

PR: Well, it's a long-term business and change comes very slowly to our industry... There are a host of forces being directed at the financial services and insurance industry. We've got Solvency II requirements coming out of Europe that are fairly dramatic and the EU is pushing hard for global equivalency. We've got new accounting rules on top of solvency rules, and we've got disclosure rules that apply more to other businesses than ours. Does the FIO step into these issues?

GL: I think the FIO will likely step into these issues in one way or another. How much it does and how helpful it can be, to some degree, will depend on the industry itself. Again, the effectiveness of the FIO will depend on circumstances and personality. But I share your worry about the implications of Solvency II and mark-to-market accounting rules and how they impact insurance.

PR: I think it's interesting that the industry came through the financial crisis fairly well, due in no small part to the role played by state insurance regulators. Companies were able to work very effectively with the state regulators to cobble together temporary measures that have held up quite well. I'm not sure the federal government could have acted to that degree to try to do the right thing. Do you see the industry backing off a little in its pursuit of a federal charter because of this?

GL: I think the industry has come through the crisis quite well. Had it not been for AIG, I think the industry would have avoided the spotlight.

The multi-product global enterprise is the kind of issue that gives rise to concerns at the federal level. These concerns do not exist if you're talking about businesses that are more homogeneous. The degree to which technology and globalization create more large, multi-product insurance companies, as it did in banking, will be the big issue.

Limits of a Global Focus

PR: In terms of globalization of insurance, I think it's a bit of a fiction. Life insurance, especially, is a very local business that has to adapt to the local culture, tax issues, business norms, regulatory environment, etc. Globalization is hard to envision. You can own a bunch of companies in a number of countries, but whether or not it's a true global business remains to be seen, I think.

GL: There is a great deal to be said for local financial businesses, local insurance companies, serving their markets as they have for generations. Notwithstanding that community focus, clearly there are huge pressures and certainly momentum for large pools of capital and talent, and I don't think that's going to change. The U.S. through Dodd-Frank has put limits on the banking organization but there are fewer limits in Europe and Asia. Indeed, we have already seen multiline U.S. banks actually become smaller, relatively speaking, to the largest global players.

PR: I think the financial crisis was a reminder that in times of crisis, every national market acts in its self interest. There was no global view of bailouts. It was every regulator at every jurisdictional level doing what it could to protect its people and its institutions.

GL: You're quite right, Paul. The tendency to "ring fence" the enterprises in political jurisdictions has been high and still is. And I don't see that changing. If anything there's been a little bit of a swing back to the local level. Still, we see in Canada, Germany, France, Switzerland, Japan, even Australia and certainly China, the momentum to build large global companies and that momentum continues.

Keeping Up with the Market?

PR: Obviously you were in the middle of all this in the early and mid '90s as Comptroller of the Currency. The financial business has changed so dramatically over the last 15 years, and regulation has never kept up with the pace of change. Do you think it ever will?

GL: No. The business of finance has become very much a product of technology and the information revolution. I don't see that changing. That means the regulations will, almost by nature, be behind the curve. Dodd-Frank and Basel III are attempts to slow down the change but it doesn't stop it. And I don't think Basel III and Dodd-Frank are going to slow it down in China, Singapore, Japan and a number of other countries.

PR: Any closing comments on the insurance industry and financial services, regulations and development?

GL: Only that we are fortunate to have a superb insurance sector and a large number of independent community-based insurance companies. That's a strength for the country and I hope that the federal bureau respects that, and I believe it will.



Visit our web site at www.TransamericaReinsurance.com

Main Marketing Office
Transamerica Square
401 North Tryon Street
Charlotte, North Carolina 28202
704.344.2700

Asia Pacific Head Office
58/F One Island East
18 Westlands Road
Island East, Hong Kong
852.2877.6222

Latin America Head Office
Transamerica Square
401 North Tryon Street
Charlotte, North Carolina 28202
704.344.2700

Europe Head Office
7 Place de la Defense
92974 Paris La Defense Cedex
France
33.1.49.67.81.60

The information conveyed and the views expressed in this newsletter are provided for informational purposes only and are based on opinions and interpretations made by Transamerica Reinsurance. The opinions and interpretations expressed by Transamerica Reinsurance may not be the only interpretation available. This publication should not be copied or shared with any other company, reinsurer or consultant without obtaining prior approval from Transamerica Reinsurance.

Transamerica Reinsurance, a division of Transamerica Life Insurance Company.

an  company

Printed in USA © 2010 Transamerica Life Insurance Company