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New era
Regulator outlines changes in financial services industry

by Jose Montemayor

The insurance industry is at the threshold of a new era. This era will be characterized by increased pressures for insurers to consolidate with other insurers, banks, and securities dealers to compete with newly created financial services giants. These new financial conglomerates will be able to provide a full range of financial services under common brand names.

More importantly, this new era very likely will be characterized by many opportunities arising from regulatory efficiencies, congressional actions, and the creativity of the industry itself. The result should be more financial services products, including insurance, for more people at more competitive prices than at any other time in history. The industry will have an opportunity to deliver more value to the consumer than ever before.

This article offers a regulator's perspective on changes in the state regulatory environment driven by the regulators themselves, as well as potential changes in the competitive environment prompted by the Financial Services Modernization Act (U.S. Senate Bill 900).

Regulators at the forefront
Changes arising from the regulators' own initiatives include the NAIC's recently adopted accounting codification guidance that unifies into a comprehensive body of accounting all of the statutory accounting guidance previously contained in the various accounting manuals and other sources. The codification project received a great deal of input from all major industry groups and the accounting profession, and it was staffed by regulators who are among the nation's top experts in statutory accounting and state insurance regulation. This project's net effect will be the modernization of accounting guidance, which will now more closely parallel current GAAP guidance. Codification's benefits include more consistent accounting systems for statutory and GAAP accounting for financial reporting. In Texas, we plan to adopt, by rule, the codification guidance as a basis of accounting, effective Jan. 1, 2001.

State regulators, through the NAIC, are undertaking other initiatives focused on improved efficiency, standardization, and modernization.

For example, the ALERT initiative (Accelerated Licensing Evaluation Review Technique) contemplates a consolidated application for admitted carrier status in the different states using standardized forms and online systems for submission. Another initiative envisions licensing agents through the Producer Information Network (PIN). Agents and brokers, using standardized forms, will be able to simultaneously apply online for licensure in all 50 states.

Already in place is the new System for Electronic Rate and Form Filing (SERFF), which enables participating companies to apply online simultaneously for policy form and premium rate approvals in all 50 states.

The objective of the ALERT, PIN, and SERFF initiatives was specifically to standardize and streamline insurance regulation. The intended results include reduced compliance costs for insurers, costs that might otherwise be passed on partly or totally to policyholders.

Several other lower-profile NAIC initiatives now being implemented are designed to improve the efficiency of financial regulation by state insurance departments. For example, the states have adopted a new risk-based

approach to financial examinations that calls for greater use of CPA work papers, where available, to avoid duplication of effort. Additionally, the NAIC has reviewed its system of association examinations (commonly known as "zone examinations") and updated the thresholds that identify companies subject to zone examinations. This review also led to measures that improved the productivity of zone examiners.

New computerized financial monitoring tools and screening techniques developed by the NAIC enable insurance department analysts to handle very large volumes of financial information. In Texas, for example, we review approximately 10,000 annual and quarterly financial statements each year with a staff of analysts and support personnel totaling fewer than 60 people. These productivity improvements are made possible by computer screening using sophisticated algorithms and trend analysis to help us allocate staff resources.

On the international front, state regulators are actively participating as technical advisors to our foreign trade negotiators with the U.S. Trade Representative's Office as well as with the U.S. Commerce Department in the

(continued on page 4)

New era (continued from page 3)

negotiation of treaties, such as the General Agreement on Trade in Services, relating to financial services. These efforts seek ways whereby regulators in different countries may give mutual recognition to solvency monitoring and market regulation to avoid costly duplication of regulatory filings and examinations when insurers desire to enter other nations' markets.

In Washington

Perhaps the single greatest development may come from the U.S. Congress, which is considering the repeal of the Depression-era Glass-Stegall Act.

The Financial Modernization Act of 1999, now known as S. 900, is currently undergoing conference committee review to reconcile differences between the House and Senate versions of this legislation. Clearly, passage of S. 900 would have a major impact in the way financial services are provided and regulated, greatly reducing the fragmentation of the past 60 years. Because of Glass-Stegall's required separation of the banking, insurance, and securities industries, we probably have one of the more fragmented financial sectors in the world.

S. 900 does present serious issues, which we hope will be worked out, regarding federal preemption of state consumer protections. Most state insurance regulators overwhelmingly support financial services modernization, but only if these preemption issues can be resolved.

International developments

Overseas, including most of the European Union countries, financial products are offered by financial conglomerates and are often regulated by a single regulator. These financial giants are able to deliver a full range of services and are regulated by a single entity such as the U.K. Financial Services Authority, which evolved from the old Department of Trade and Industry.

In many other regulatory models around the world, the nation's central financial ministry is the primary regulator. For example, in Canada the Ministry of Finance is the primary government agency that oversees the regulation of insurance. The Canadian system is unique in that insurance regulation is further split between the national and provincial governments. The national government is responsible for solvency monitoring and holding company transaction approval, while the provinces are responsible for form and rate approval and consumer protection.

Financial 'superstores'

The ability to exploit economies of scale and regulatory efficiencies presents a number of advantages to foreign financial conglomerates. The full implementation of regulatory standardization initiatives and the enactment of S. 900 would make those same advantages available to U.S. financial conglomerates, which would be able to associate among themselves and deliver a full range of products under a single brand name. It may soon be possible, for the first time in our modern history, to put together financial "superstores" that can create and distribute a full range of financial products through various market channels ranging from storefronts to Web sites.

This ability to associate should present some interesting consolidation opportunities to the approximately 10,000 banks, 4,000 insurers, and 500 securities brokers in the United States. I fully expect to see an ever-increasing pace of these consolidations as financial services providers seek to meet consumer demands. I also expect the classic "make or buy" economic analysis model to change drastically because of merger-and-acquisition possibilities.

To a limited extent, we have already seen a convergence in the financial services market with developments including alternative risk transfers in lieu of traditional reinsurance, such as securitization of risks, particularly in catastrophe risk management. Such alternatives often bring together the securities and insurance sectors. A conglomerate's retail orientation, as well as strong regional or national brand identification, should command a premium in the financial market as risk managers and consumers consider alternatives for financial services.

I also fully expect continued globalization of the financial services industry as, for example, European and other offshore financial giants vie for fuller participation in the U.S. financial services market and continue to acquire U.S. companies for that purpose. The converse also is expected as U.S. companies continue seeking greater global market share by establishing a presence both in Europe and in third-world countries.

In the end, if regulatory issues with S. 900 can be resolved, the real winner in the midst of all these changes and new opportunities will be U.S. consumers. They will have available a full range of financial products at competitive prices and an ever-increasing set of choices regarding financial products and services. New opportunities in the financial services sector truly constitute a new era for the insurance industry and should excite all insurance professionals with the possibilities ahead.

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