

AS  
PRESENTED

NEW YORK INSURANCE DEPARTMENT  
HEARING ON THE FUTURE OF THE NEW YORK INSURANCE EXCHANGE  
DECEMBER 21, 1987

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STATEMENT BY PETER H. BICKFORD

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INTRODUCTION

SUPERINTENDENT CORCORAN, DISTINGUISHED PANEL, LADIES AND GENTLEMEN: I APPRECIATE THE OPPORTUNITY TO APPEAR BEFORE YOU TODAY TO COMMENT ON THE FUTURE OF THE NEW YORK INSURANCE EXCHANGE.

MY NAME IS PETER BICKFORD. I WAS THE FIRST GENERAL COUNSEL OF THE NEW YORK INSURANCE EXCHANGE, SERVING IN THAT CAPACITY FROM JANUARY 1980 -- BEFORE THE EXCHANGE OPENED -- UNTIL SEPTEMBER 1985. SINCE LEAVING THE EMPLOY OF THE EXCHANGE, I HAVE REPRESENTED AND COUNSELED MANY NEW YORK INSURANCE EXCHANGE PARTICIPANTS, INCLUDING:

- ACTIVE UNDERWRITING SYNDICATES
- SYNDICATES DECLARED INSOLVENT BY THE EXCHANGE BOARD
- BROKER MEMBERS
- UNDERWRITING MANAGERS
- THE NEW YORK SYNDICATE MEMBERS ASSOCIATION
- SYNDICATE INVESTORS, AND
- POTENTIAL SYNDICATE INVESTORS.

MY APPEARANCE HERE TODAY, HOWEVER, IS NOT ON BEHALF OF ANY OF THESE PARTIES. I AM HERE ON MY OWN BEHALF AS A FRIEND OF THE INSURANCE EXCHANGE CONCEPT AND ON BEHALF OF ALL THOSE PEOPLE WHO HAVE PUT SO MUCH EFFORT INTO TRYING TO MAKE INSURANCE EXCHANGES WORK IN THE UNITED STATES DURING THE DIFFICULT CYCLES OF THE LAST SEVEN YEARS.

MY INTEREST IN THE AMERICAN INSURANCE EXCHANGES AND CONCERN FOR THEIR PLACE IN THE INSURANCE INDUSTRY HAS BEEN WELL DOCUMENTED BY MY NUMEROUS ARTICLES AND SPEECHES ON THE EXCHANGES, AND MOST RECENTLY BY MY TEXT AND REFERENCE VOLUME TITLED EXCHANGE:™ A GUIDE TO AN ALTERNATIVE INSURANCE MARKET BEING PUBLISHED BY NILS PUBLISHING COMPANY. I BELIEVE, THEREFORE, THAT I AM WELL QUALIFIED TO OBSERVE, COMMENT AND OPINE ON THE SUBJECT OF THIS HEARING -- THE NEW YORK INSURANCE EXCHANGE.

IN THE LAST FOUR MONTHS WE HAVE WITNESSED ONE OF THE FASTEST UNNATURAL DISASTERS SINCE THE FALL OF SAIGON. IN VIEW OF THE RAPIDITY OF EVENTS, THERE HAS BEEN LITTLE TIME FOR THE VICTIMS OF THE DISASTER TO FULLY REFLECT AND ABSORB ITS CONSEQUENCES. THE PANEL IS THEREFORE RESPECTFULLY URGED TO CONSIDER THE FRESHNESS OF EVENTS IN ITS DELIBERATIONS, AND NOT BECOME A PARTICIPANT IN THE MOMENT. IN OTHER WORDS, THE QUICKNESS OF THE COLLAPSE OF THE NEW YORK INSURANCE EXCHANGE DOES NOT NECESSARILY REQUIRE AN EQUALLY QUICK RESPONSE FROM THE DEPARTMENT, IF, IN FACT, ANY RESPONSE FROM THE DEPARTMENT IS NECESSARY.

WITH THAT GENTLE CAUTION IN MIND, I WOULD LIKE TO RECORD SOME OF MY THOUGHTS WITH YOU FOR YOUR CONSIDERATION.

## **BACKGROUND**

AT THE END OF AUGUST 1987 -- EVEN THOUGH EIGHT NEW YORK INSURANCE EXCHANGE SYNDICATES HAD BEEN DECLARED INSOLVENT BY THE EXCHANGE AND ANOTHER TEN HAD PETITIONED FOR WITHDRAWAL -- THE EXCHANGE STILL HAD 19 SYNDICATES AND 10 UNDERWRITING MANAGERS CAPABLE OF WRITING BUSINESS WITH POLICYHOLDER SURPLUS IN EXCESS OF \$150 MILLION.

ACTIVE SYNDICATES WERE BEGINNING TO SHOW A PATTERN OF FAVORABLE RESULTS FOR THE FIRST TIME IN THEIR EXISTENCE. THERE WAS RELIEF BY THE ACTIVE MARKET THAT THE EXODUS HAD NOT BEEN GREATER, AND THERE WAS A HINT OF OPTIMISM -- EVEN AMONG POTENTIAL INVESTORS -- THAT

PERHAPS THE BAD NEWS HAD BOTTOMED OUT. AS WE NOW KNOW, THAT OPTIMISM WAS UNWARRANTED.

THE HIGH DRAMA WHICH OCCURED FROM THE BEGINNING OF SEPTEMBER 1987 UNTIL THE MEMBERS ACCEPTED THE RECOMMENDATION OF THE BOARD OF GOVERNORS TO CLOSE THE TRADING FLOOR ON NOVEMBER 23, 1987, WAS CHRONICLED ALMOST DAILY IN THE TRADE PRESS, SPURRED BY ACTIONS OF THE EXCHANGE'S BOARD WHICH SEEMED TO FUEL RATHER THAN STEM THE FLIGHT FROM THE MARKET. THE RESULTING CLOSURE SERIOUSLY AND NEEDLESSLY JEOPARDIZES THE WHOLE INSURANCE EXCHANGE CONCEPT IN THIS COUNTRY, IS FORCING MANY SYNDICATES AND MANAGERS OUT OF BUSINESS AGAINST THEIR WILL, AND -- MOST IMPORTANTLY -- IS COSTING HUNDREDS OF PEOPLE THEIR JOBS.

WHILE MANY EXCHANGE OBSERVERS -- INCLUDING MYSELF -- MAY BE INTELLECTUALLY INTRIGUED BY THE EVENTS OF THE LAST FOUR MONTHS AND THE UNANSWERED QUESTIONS THEY RAISE, FOCUSSING ON THESE EVENTS NOW COULD DISTRACT FROM THE PURPOSE OF THIS HEARING: TO CONSIDER THE FUTURE OF THE NEW YORK INSURANCE EXCHANGE. I WILL THEREFORE SPEAK TO THE FUTURE, KEEPING IN MIND, HOWEVER, THAT PAST IS PROLOGUE.

THE BEST PLACE TO START IN DISCUSSING THE FUTURE OF THE NEW YORK INSURANCE EXCHANGE IS WITH THE EXCHANGE BOARD'S OWN STATEMENTS OF THAT FUTURE.

### THE STEWART REPORT

AT THE MEMBERS MEETING ON NOVEMBER 23, 1987, THE BOARD AND MANAGEMENT OF THE NEW YORK INSURANCE EXCHANGE EMPHASIZED TO THE MEMBERS THAT THE DECISION TO CLOSE THE FACILITY WAS A TEMPORARY ACTION TO ALLOW IT TO REASSESS ITS STATUS AS A MARKET AND TO CONSIDER VARIOUS CHANGES FOR FUTURE OPERATIONS. AS PROOF OF THIS INTENT, AND AS A BASIS FOR ITS FUTURE COURSE, THE BOARD DISTRIBUTED A REPORT TO THE MEMBERS TITLED THE NEW YORK INSURANCE EXCHANGE -- FUTURE DIRECTIONS, PREPARED FOR THE BOARD BY STEWART ECONOMICS,

INC. AND INVITED RICHARD STEWART, ONE OF THE CO-AUTHORS OF THE REPORT, TO SUMMARIZE ITS MAIN ELEMENTS FOR THE MEMBERS.

THIS REPORT, REFERRED TO AS THE STEWART REPORT, WAS DATED OCTOBER 23, 1986. ALTHOUGH IT HAD BEEN PREPARED AT MEMBERS' EXPENSE THIRTEEN MONTHS EARLIER, THE STEWART REPORT HAD NOT BEEN ISSUED TO THE MEMBERS PRIOR TO THE VOTE TO CLOSE THE FACILITY. IN FACT, EVEN THE TRADE PRESS WAS GIVEN COPIES OF THE REPORT BEFORE THE MEMBERS. FOR OVER A YEAR THE MEMBERS HAD BEEN TOLD AT VARIOUS TIMES THAT THE REPORT WAS BEING REVISED, . . . OR STUDIED, . . . OR ANALYZED, . . . OR DIGESTED INTO MORE READABLE FORM. I HAVE NOW READ AND REREAD THE REPORT AND FAIL TO UNDERSTAND WHAT WAS SO DISTURBING ABOUT THE REPORT THAT CAUSED THE BOARD OF GOVERNORS TO KEEP IT FROM THE EYES OF THE MEMBERS FOR OVER A YEAR, AND ONLY RELEASE IT AFTER THE VOTE TO CLOSE THE FACILITY HAD BEEN COMPLETED.

FOR THOSE OF YOU WHO HAVE NOT YET READ IT, I CAN ASSURE YOU THAT THE STEWART REPORT IS EMINENTLY READABLE . . . IT IS FULL OF USEFUL AND PROVOCATIVE ANALYSIS . . . YET IT IS A FRACTION OF THE LENGTH AND SCOPE OF THE MAY, 1980 FISHER REPORT ON THE FUTURE OF LLOYDS WHICH WAS OPENLY SHARED WITH THE ENTIRE INSURANCE WORLD . . . AND IT COULD HAVE BEEN THE SUBJECT OF USEFUL DISCUSSION AND COMMENT BY THE ENTIRE EXCHANGE COMMUNITY . . . IF IT HAD BEEN FULLY AND OPENLY SHARED WITH THE MEMBERSHIP WHEN FIRST ISSUED TO THE BOARD.

AS YOU WILL SEE, I DO NOT AGREE WITH ALL OF THE RECOMMENDATIONS AND CONCLUSIONS OF THE REPORT, BUT I BELIEVE THE ISSUES RAISED BY IT ARE CENTRAL TO THE FUTURE OF THE NEW YORK INSURANCE EXCHANGE AND DESERVE TO BE DISCUSSED AND ANALYZED. I ALSO BELIEVE THAT, BY ITS ACTIONS, THE EXCHANGE BOARD RAISES QUESTIONS OF ITS OWN UNDERSTANDING AND INTERPRETATION OF THE REPORT WHICH IT COMMISSIONED.

AFTER A DISCUSSION OF THE HISTORY AND FUNDAMENTALS OF THE NEW YORK INSURANCE EXCHANGE, THE STEWART REPORT OFFERS FOUR RECOMMENDATIONS FOR THE FUTURE DIRECTION OF THE NEW YORK INSURANCE EXCHANGE. ALTHOUGH FULL ANALYSIS WOULD TAKE UP TOO

MUCH TIME HERE, I WOULD LIKE TO RESPOND BRIEFLY TO THESE RECOMMENDATIONS, AND TO OFFER AN OVERVIEW FOR YOUR CONSIDERATION.

IN SUMMARY, THE FOUR RECOMMENDATIONS OF THE STEWART REPORT ARE AS FOLLOWS:

1. REDUCE BUSINESS UNCERTAINTY OVERHANGING THE EXCHANGE FROM THE PAST;
2. MAKE THE EXCHANGE MORE HOSPITABLE TO LARGE CAPITAL AND TOP TALENT;
3. INCREASE FREEDOM AND DECREASE COSTS IN THE OPERATING ENVIRONMENT; AND
4. CONCENTRATE ON WHAT IS WITHIN THE EXCHANGE'S POWER TO ACCOMPLISH.

## **ANALYSIS OF RECOMMENDATIONS**

### **RECOMMENDATION #1. UNCERTAINTY FROM THE PAST.**

THE STEWART REPORT STATES THAT: "IF THE EXCHANGE IS GOING TO SUCCEED, IT IS GOING TO HAVE TO CONVINCED PRESENT AND POTENTIAL INVESTORS AND BROKERS THAT PAST PROBLEMS WILL NOT BECOME THEIR PROBLEMS." I CONCUR WITH THIS CONCLUSION. I ALSO CONCUR THAT THE TWO AREAS OF CONCERN IDENTIFIED BY THE REPORT -- THE "FINANCIALLY MARGINAL" SYNDICATES AND THE BACK OFFICE SHORTCOMINGS -- ARE THE TWO TOPICS OF MOST CONCERN TO PROSPECTIVE EXCHANGE PARTICIPANTS. THE BACK OFFICE PROBLEMS ARE DEALT WITH UNDER RECOMMENDATION #3, DISCUSSED LATTER. THE DISCUSSION UNDER THIS RECOMMENDATION RELATES PRIMARILY TO THE FINANCIALLY TROUBLED SYNDICATES.

THE REPORT CONCLUDES THAT THE BOARD OF THE EXCHANGE SHOULD DECLARE INSOLVENT SYNDICATES INSOLVENT AND PETITION FOR THEIR

LIQUIDATION WITHOUT REGARD TO ANY SYNDICATE PROPOSALS, PLANS, PROGRAMS OR PROMISES. KEEPING IN MIND THAT THIS REPORT WAS ISSUED TO THE BOARD OVER A YEAR AGO, THIS RECOMMENDATION MAY HELP US UNDERSTAND THE CONFUSION SURROUNDING THE FINANCIALLY TROUBLED SYNDICATES IN THE PAST YEAR. DID RELIANCE ON THE REPORT RESULT IN A RUSH TO PETITION FOR LIQUIDATION BEFORE ALL REASONABLE EFFORTS HAD BEEN MADE TO SAVE THE SYNDICATES? AND IN THE PROCESS DID THE BOARD IGNORE THE SIMPLEST BASICS OF DUE PROCESS?

BUT EVEN WITH THE LIQUIDATION PETITIONS, THE PERCEPTION PERSISTED THAT THE EXCHANGE WAS NOT -- AND STILL IS NOT -- IN CONTROL OF THE FINANCIAL SITUATION. I OFFER THREE POSSIBLE REASONS FOR THIS CONTINUING PERCEPTION.

FIRST, THERE IS A BASIC PRINCIPLE IN THE BANKING BUSINESS THAT ONCE THE DECISION IS MADE TO GRANT A LOAN, YOU LOAN ALL THE BORROWER NEEDS. LENDING LESS THAN THE FULL AMOUNT ONLY JEOPARDIZES THE VIABILITY OF THE TRANSACTION. THE SAME PRINCIPLE CAN BE APPLIED TO DEALING WITH FINANCIALLY MARGINAL SYNDICATES. I BELIEVE THAT THE ESSENCE OF THE STEWART REPORT RECOMMENDATION IS THAT THE BOARD SHOULD MAKE A DECISION TO EITHER SUPPORT A SYNDICATE'S PLAN OR NOT. IF YOU SUPPORT THE PLAN, SUPPORT IT TO THE FULLEST EXTENT OF THE BOARD'S POWER AND AUTHORITY. IF THE DECISION IS NOT TO SUPPORT, TAKE THE NECESSARY CONSTITUTIONAL ACTION PROMPTLY. IN MANY CASES, HOWEVER, THE BOARD DID NEITHER, OFTEN LEAVING THE OWNERS AND MANAGEMENT OF THE SUBJECT SYNDICATE CONFUSED AS TO THE RULES OF THE GAME, OR WITH THE BELIEF THEY HAD BEEN OFFERED USELESS HALF LOAVES, AND NOT KNOWING WHERE THEY STOOD.

THIS CONFUSION CAUSED THE SPENDING OF COUNTLESS HOURS OF ULTIMATELY FRUITLESS ENERGY ON THE FALSE HOPE OF SOME SATISFACTORY SOLUTIONS. THE END RESULT SATISFIED NO ONE.

SECOND, THE BOARD AND MANAGEMENT FAILED TO COMMUNICATE EFFECTIVELY WITH ITS MEMBERSHIP. THE PERSISTENT VIEW IS THAT THE MEMBERS WERE NEVER TOLD THE TRUE STORY ABOUT THE FINANCIALLY TROUBLED SYNDICATES. NOT BEING INFORMED, PEOPLE RUMORED THE

WORST, WHICH BECAME FACT THROUGH THE RESULTING LOSS OF CONFIDENCE. IT SEEMS OBVIOUS THAT MANAGEMENT OF A MEMBERSHIP ORGANIZATION MUST BE ABLE TO COMMUNICATE MEANINGFUL INFORMATION ON A TIMELY BASIS TO ITS MEMBERSHIP. I DO NOT BELIEVE MOST MEMBERS OF THE EXCHANGE CONSIDER THEY HAVE RECEIVED SUCH COMMUNICATION.

THIRD, THIS WHOLE AREA POINTS UP THE BASIC CONFLICT BETWEEN THE TWO PRIMARY RESPONSIBILITIES OF THE EXCHANGE MANAGEMENT: ITS ROLE AS REGULATOR AND ITS ROLE AS PROMOTER OF THE FACILITY. IF THERE IS A CHANGE WHICH COULD BE CONSIDERED FOR FUTURE OPERATIONS ON THE EXCHANGE, PERHAPS IT SHOULD BE TO PROVIDE FOR AN AUTONOMOUS AUDIT FUNCTION OF THE FACILITY REPORTING DIRECTLY TO THE AUDIT COMMITTEE OF THE BOARD. THIS WOULD EFFECTIVELY FREE THE EXCHANGE MANAGEMENT TO CONCENTRATE ON MANAGING THE FACILITY FOR THE WRITING OF BUSINESS.

FINALLY, THE RECOMMENDATION OF THE STEWART REPORT ALSO SUGGESTS THAT IF, IN DEALING WITH THE INSOLVENCIES, THE SECURITY FUND IS NOT RESPONSIVE TO THE EXCHANGE'S NEEDS, CONSIDERATION SHOULD ULTIMATELY BE GIVEN TO ABOLISHING THE SECURITY FUND. I HEARTILY DISAGREE WITH ANY SUGGESTION THAT ELIMINATION OF THE SECURITY FUND IS WARRANTED UNDER ANY CIRCUMSTANCES. A FUND -- WHETHER A SECURITY OR GUARANTY FUND, OR A CONTINGENCY FUND AS AT LLOYD'S -- WHICH PROVIDES PARTICIPANTS IN THE MARKET WITH A STAKE IN THE CONDUCT OF ALL OTHER PARTICIPANTS, IS AN ESSENTIAL ELEMENT OF AN INSURANCE EXCHANGE. IF YOU DELETE THE FUND, YOU DO NOT HAVE AN INSURANCE EXCHANGE.

## **RECOMMENDATION #2. CAPITAL AND TALENT**

THE SECOND STEWART REPORT RECOMMENDATION IS THAT THE EXCHANGE SHOULD SEEK A MINIMUM CAPITAL OF \$25 MILLION FOR SYNDICATES ON THE PREMISE THAT ONLY SIGNIFICANTLY CAPITALIZED SYNDICATES CAN ATTRACT THE UNDERWRITING TALENT AND BROKER INTEREST TO WRITE THE TYPES OF BUSINESS WHICH THE REPORT BELIEVES ARE THE NEW YORK

INSURANCE EXCHANGE'S NATURAL MARKETS: TREATY AND LARGE FACULTATIVE REINSURANCE, AND LARGE SURPLUS LINES RISKS.

ALTHOUGH I AGREE THAT CAPITAL MAY ATTRACT TALENT AND INTEREST, I STRONGLY DISAGREE WITH THE PREMISES AND CONCLUSIONS OF THE RECOMMENDATION FOR THE FOLLOWING REASONS:

THE EXCHANGE MEMBERSHIP HAS BEEN IN TRANSITION DURING THE LAST FEW YEARS. LARGE COMPANY BACKED SYNDICATES WHICH HAD BEEN THE ORIGINAL BACKBONE OF THE EXCHANGE WERE LEAVING TO BE REPLACED BY ENTREPRENEURIALY BACKED SYNDICATES OF VARYING SIZES AND OWNERSHIP. THIS TRANSITION WAS A HEALTHY DEMONSTRATION OF THE GROWING MATURITY OF THE MARKET AND ITS LESSENING DEPENDENCE ON THE MAJOR INSURERS FOR ITS EXISTENCE. THE STEWART REPORT RECOMMENDATION, AS SUPPORTED BY THE EXCHANGE BOARD, DISCOURAGES THIS NATURAL EVOLUTION AND IMPOSES AN ARTIFICIAL DEVELOPMENT PATTERN ON THE MARKET.

THE RECOMMENDATION FAILS TO RECOGNIZE THAT THERE ARE OTHER MEANS OF ACCUMULATING CAPITAL AND TALENT ON AN EXCHANGE. SEVERAL UNDERWRITING MANAGERS WERE DEVELOPING AND SEEKING INVESTOR GROUPS TO FUND SERIES OF SYNDICATES OF MODERATE SIZE UNDER A COMMON MANAGER. ONE MANAGER WITH FIVE SYNDICATES CAPITALIZED AT \$5 MILLION HAS THE SAME TALENT APPEAL, GROWTH POTENTIAL AND CAPITAL BASE AS ONE \$25 MILLION SYNDICATE. IT HAS THE ADDED ADVANTAGE, HOWEVER, OF A VARIETY OF PARTICIPATION, BUSINESS PERSPECTIVES AND OWNERSHIP -- BASIC ELEMENTS OF A TRUE INSURANCE EXCHANGE.

THE RECOMMENDATION ALSO SUMMARILY DISMISSES THE POSSIBILITY OF DEVELOPING SPECIALTY SYNDICATES REQUIRING SMALLER CAPITAL BASES. I HAVE PERSONAL KNOWLEDGE THAT SEVERAL SUCH ENTITIES WERE PREPARED TO JOIN THE EXCHANGE BUT WERE DISCOURAGED BY THE LACK OF INTEREST IN THEM BY THE EXCHANGE MANAGEMENT.

FURTHERMORE, THE RECOMMENDATION FAILS TO CONSIDER OTHER MEANS OF AVOIDING THE OVERWRITING OF SMALLER CAPITALIZED ENTITIES. FOR



INSTANCE, THE BOARD COULD DEVELOP STRICTER WRITING LIMITS FOR LOWER LEVELS OF CAPITALIZATION, THUS ENCOURAGING SMALLER SYNDICATES TO INCREASE CAPITAL FOR GREATER FLEXIBILITY WITHOUT FORCING THEM OUT OF THE MARKET.

FINALLY, SIZE ITSELF DOES NOT MEAN SAFETY. THREE EXAMPLES SHOULD SUFFICE TO MAKE THE POINT:

- MISSION INSURANCE COMPANY
- UNION INDEMNITY INSURANCE COMPANY
- THE TITANIC

THE BOTTOM LINE, HOWEVER, IS THAT THE STEWART REPORT RECOMMENDATION CONSTITUTES NOTHING MORE THAN A POOLING OF COMPANIES. AT \$25 MILLION MINIMUM CAPITAL, THESE ENTITIES ARE LARGE ENOUGH TO BECOME LICENSED INSURERS WITH A MINIMUM OF HASSLE -- EVEN IN NEW YORK -- AND GAIN SIGNIFICANT MARKET RECOGNITION WITHOUT AN EXCHANGE. THE EXCHANGE LEGISLATION IS NOT NEEDED BY A GROUP OF LARGE INSURERS OR REINSURERS TO CREATE SUCH A POOLING ARRANGEMENT.

THE SUGGESTION IN THE STEWART REPORT THAT THE LARGER SYNDICATES WILL AMELIORATE OR SHIFT ATTENTION FROM OTHER EXCHANGE PROBLEMS -- SUCH AS THE BACK OFFICE PROBLEMS -- MUST HAVE BEEN PARTICULARLY APPEALING TO THE EXCHANGE BOARD AND MANAGEMENT: A QUICK FIX!! A MEANS OF REFORESTING THE DEVASTATION WITH FULL GROWN TREES.

WHEN VIEWING THIS RECOMMENDATION IN HISTORICAL PERSPECTIVE OVER THE LAST YEAR -- WHEN THE STEWART REPORT WAS KNOWN TO THE BOARD AND NOT THE MEMBERS -- IT IS CLEAR THAT THE BOARD WAS ATTEMPTING TO IMPLEMENT THE RECOMMENDATION WITHOUT SHARING IT WITH OR CONSULTING THE MEMBERSHIP ON ITS ACCEPTABILITY. THE BOARD ONLY HALF SUCCEEDED. IT MANAGED TO DISCOURAGE SEVERAL KNOWN INVESTOR GROUPS WITH \$5 TO \$10 MILLION SYNDICATES, BUT FAILED TO ATTRACT ANY OF THE \$25 MILLION "SAVIOR" SYNDICATES.

THE MOST DIFFICULT ASPECT OF THIS PARTICULAR RECOMMENDATION IS

THE BOARD'S BELIEF THAT IT IS ITS PROVINCE TO DETERMINE THE DIRECTION, WRITINGS, AND FUTURE COURSE OF THE EXCHANGE. PERHAPS THE FAILING HERE IS THE BACKGROUND OF THE BOARD ITSELF. ITS MEMBERS ARE SENIOR OFFICERS OF MAJOR CORPORATIONS. THEY SIT ON BOARDS OF DIRECTORS OF FOR-PROFIT CORPORATIONS WHERE IT IS THEIR OBLIGATION TO MAP THE COURSE OF THE ENTITY AND ACT ON THE RECOMMENDATIONS OF MANAGEMENT. ULTIMATELY, THE BOTTOM LINE PROVIDES ACCOUNTABILITY.

ON THE EXCHANGE, HOWEVER, THEY SIT NOT AS DIRECTORS OF A FOR-PROFIT CORPORATION, BUT AS GOVERNORS OF A FACILITY RUN FOR THE BENEFIT OF MEMBERS. THE ACCOUNTABILITY IS FAR MORE SUBJECTIVE -- TO SERVICE THE NEEDS OF THE MEMBERS, ALLOWING THEM TO CONDUCT A PROPER INSURANCE OR REINSURANCE BUSINESS ON THE EXCHANGE UNDER REASONABLE CONDITIONS AT REASONABLE COSTS. THE MEMBERS -- NOT THE BOARD -- SHOULD CHART THE COURSE OF BUSINESS ON THE EXCHANGE.

THE MAIN POINT IS THAT EVEN IF THE STEWART REPORT RECOMMENDATION IS VALID, IT IS NOT THE JURISDICTION OF THE BOARD OF GOVERNORS TO MAKE THAT DETERMINATION.

### **RECOMMENDATION #3. THE OPERATING ENVIRONMENT**

THE STEWART REPORT'S THIRD RECOMMENDATION INCLUDES A NUMBER OF RECOMMENDATIONS FOR ALLOWING GREATER FREEDOM OF ACTION ON THE EXCHANGE AND FOR REDUCING THE COSTS OF OPERATION ON THE EXCHANGE. FOR THE MOST PART I CONCUR IN THESE CONCLUSIONS AND SUGGEST A CAREFUL READING OF THE REPORT CONCERNING THESE POINTS. I WOULD LIKE TO MAKE A FEW GENERAL OBSERVATIONS, HOWEVER.

FIRST, ALTHOUGH THE REDUCTION OF SERVICES MAY BE NECESSARY TO CREATE A COST EFFECTIVE FACILITY, CONSIDERABLE ATTENTION SHOULD ALSO BE GIVEN TO THE STRUCTURE OF THE FACILITY PROVIDING THE SERVICES. NO MATTER HOW GOOD THE PEOPLE RUNNING THE MACHINE, IF IT IS A RUBE GOLDBERG CREATION, IT WILL GIVE YOU LOTS OF NOISE AND LOTS OF ACTION FOR VERY LITTLE PRACTICAL OUTPUT.

SECOND, IT SHOULD BE KEPT IN MIND THAT ONE OF THE REGULATORY ADVANTAGES AVAILABLE TO AN INSURANCE EXCHANGE IS THE CONTROL AND ACCESS OVER TRANSACTIONS WRITTEN ON THE FACILITY. IF THE SERVICES PROVIDED BY THE FACILITY ARE REDUCED TO THE EXTENT ULTIMATELY SUGGESTED BY THE REPORT, THE MANAGEMENT OF THE FACILITY MAY LOSE THE MEANS OF SIGNIFICANT REGULATORY CONTROL OVER ITS MEMBERS. THIS RESULT WOULD BE A FURTHER DEPARTURE FROM A TRUE INSURANCE EXCHANGE.

THIRD, THE REPORT SUGGESTS THE ELIMINATION OF THE STATUTORY FREE TRADE ZONE BARRIER FOR THE EXCHANGE. I SUGGEST THAT THIS IS ONE OF THOSE ITEMS THE STEWART REPORT SHOULD HAVE INCLUDED UNDER ITS FOURTH RECOMMENDATION OF STICKING TO THOSE THINGS WHICH IT IS WITHIN THE POWER OF THE EXCHANGE TO ACCOMPLISH. WHETHER THE STATUTORY FREE ZONE BARRIERS ARE PHILISOPHICALLY JUSTIFIED OR NOT, I DO NOT BELIEVE THE EXCHANGE CAN NOW AFFORD TO FIGHT FOR THE REPEAL OF THESE BARRIERS, KEEPING IN MIND THAT THERE MAY BE A LEGITIMATE -- IF NOT TOTALLY PERSUASIVE -- ARGUMENT FOR RETAINING SOME BARRIER BETWEEN EXCHANGE SYNDICATES AND LICENSED CARRIERS.

HOWEVER, EVEN IF A STATUTORY CHANGE IS NOT PRACTICAL, THERE IS NO REASON WHY THE EXTENT OF THE RESTRICTIONS COULD NOT BE REVISED OR REDUCED BY REGULATION. THE SUPERINTENDENT HAS THE AUTHORITY TO AMEND THE REQUIREMENTS FOR FREE ZONE REJECTIONS. I WOULD SUGGEST THAT THESE REVISIONS COULD INCLUDE THE ABILITY TO DEEM ENTIRE CLASSES OR TYPES OF BUSINESS AUTOMATICALLY REJECTED OR, AT THE VERY LEAST, ALLOW REJECTIONS FOR EXPORT TO COUNT AS REJECTIONS FOR THE FREE ZONE.

#### **RECOMMENDATION #4. PRIORITIES**

I AGREE WITH THE STEWART REPORT'S LAST RECOMMENDATION THAT THE EXCHANGE SHOULD NOT SPIN ITS COLLECTIVE WHEELS ON MATTERS OVER WHICH IT HAS NO CONTROL. BUT, OF COURSE, I AM COMPELED TO MAKE AT LEAST ONE COMMENT.

THE REPORT USES THE TAX SITUATION AS ONE EXAMPLE, AND IN MAKING THIS ARGUMENT, THE REPORT REFERS TO THE TAX AMENDMENT EFFORTS OF THE EXCHANGE AS AN ATTEMPT TO ACHIEVE A TAX SHELTER. THIS IS ECHOING A MYTH WHICH IS DANGEROUS AND UNNECESSARY. THE TAX RULING REQUESTS WERE MADE TO ALLOW THE EXCHANGE SYNDICATES TO BE TREATED AS ANY OTHER INSURANCE ENTITY IN THIS COUNTRY, RECOGNIZING ONLY THAT EXCHANGE SYNDICATES CAN TAKE OTHER THAN THE CORPORATE FORM. THE TAX, RULING, HOWEVER, DENIED THE TREATMENT FOR THESE ENTITIES AS ANYTHING OTHER THAN A CORPORATION.

TAX SHELTER IS NOT AND NEVER WAS AN ISSUE. THE PURSUIT OF A CHANGE IN THE TAX RULING SHOULD NEVER BE DROPPED BY THE EXCHANGES UNTIL THIS INEQUITY IS REMOVED.

#### **OBSERVATION**

HAVING BRIEFLY REVIEWED AND COMMENTED ON THE RECOMMENDATIONS OF THE STEWART REPORT AS IT AFFECTS THE FUTURE OF THE EXCHANGE, I WOULD LIKE TO PRESENT A GENERAL OBSERVATION, FOLLOWED BY A BRIEF RECOMMENDATION WITH RESPECT TO THE FUTURE OF AN INSURANCE EXCHANGE IN NEW YORK.

BASED ON MY KNOWLEDGE OF (1) THE HISTORY AND WORKINGS OF THE EXCHANGE, (2) THE STEWART REPORT RECOMMENDATIONS, (3) THE EXCHANGE BOARD AND MANAGEMENT REACTION TO THE REPORT, AND (4) THE EVENTS OF THE LAST SEVERAL MONTHS, I BELIEVE THAT THE NEW YORK INSURANCE EXCHANGE EXPERIENCED A FAILURE IN PASSAGE FROM ITS ORIGINAL COMPOSITION -- PRIMARILY OF THE LARGE LICENSED INSURERS AND ALPHABET BROKERS WHO DIRECTED MOST OF THE ORIGINAL BUSINESS AND FUNDED THE EARLY SYNDICATES. THE EMERGING EXCHANGE WAS ONE OF EVOLUTION -- GROWING AND SUPPORTING ITSELF AS A MARKETPLACE ON ITS OWN -- WITH A MIX OF LARGE AND SMALL COMPANIES, INSURANCE AND NON-INSURANCE CAPITAL, ENTREPRENEURS AND ESTABLISHED MANAGERS, BIG AND SMALL SYNDICATES, REINSURANCE AND DIRECT SURPLUS LINES, AND EVEN SPECIALTY BUSINESS.

THE BOARD, HOWEVER, NEVER CHANGED WITH THE EXCHANGE. IT CLUNG TO THE VESTIGES OF THE OLD GUARD AND REFUSED AND STILL REFUSES TO ACKNOWLEDGE OR UNDERSTAND THE CHANGE. NOW, UNFORTUNATELY, THE BOARD SEEMS TO BE USING THE STEWART REPORT TO JUSTIFY ITS POSITION. THE REPORT AND THE EXCHANGE MARKET DESERVE BETTER.

## RECOMMENDATIONS

I THEREFORE MAKE THE FOLLOWING RECOMMENDATIONS FOR THE FUTURE OF AN INSURANCE EXCHANGE IN NEW YORK:

1. THE ENTITY KNOWN AS THE NEW YORK INSURANCE EXCHANGE, INC. SHOULD CHANGE ITS NAME TO EXCLUDE THE WORDS "INSURANCE EXCHANGE" SINCE IT NO LONGER IS, NOR DOES ITS BOARD AND MANAGEMENT INTEND FOR IT TO BE AN INSURANCE EXCHANGE IN THE FUTURE. IF THE BOARD AND MANAGEMENT WISH TO USE THAT ENTITY TO CREATE A REINSURANCE POOL OF A GROUP OF \$25 MILLION COMPANIES, LET THEM. THEY DO NOT NEED THE INSURANCE EXCHANGE STATUTE TO ACCOMPLISH THAT END.

2. LEAVE ARTICLE 62 OF THE INSURANCE LAW INTACT, AND ALLOW ANY GROUP OF INVESTORS, MANAGERS, BROKERS OR OTHER INDUSTRY LEADERS TO PURSUE USING THAT STATUTE -- IN PARTNERSHIP WITH THE INSURANCE DEPARTMENT -- TO FORM A TRUE INSURANCE EXCHANGE IN NEW YORK.

ANY SUCH GROUP, TOGETHER WITH THE LEGISLATURE AND THE INSURANCE DEPARTMENT -- SHOULD RECOGNIZE THAT TO REBUILD A TRUE INSURANCE EXCHANGE IN NEW YORK WILL REQUIRE TIME AND PATIENCE, AND CANNOT BE BURDENED WITH UNREASONABLE EXPECTATIONS. IN TIME, HOWEVER, I AM CERTAIN THAT AN INSURANCE EXCHANGE CAN BECOME A VIABLE ALTERNATIVE INSURANCE MARKET IN NEW YORK.

THANK YOU FOR YOUR ATTENTION.

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