AMERICAN ACADEMY of ACTUARIES

March 31, 2000

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th and C Streets, NW
Washington, D.C. 20551

Re: Docket No. R-1058

Dear Ms. Johnson:

This letter is written on behalf of the American Academy of Actuaries[1] to present its comments on the proposed regulation on the Privacy of Consumer Financial Information (12 CFR Part 216) published pursuant to the Gramm-Leach-Bliley Act. The Academy supports protecting the privacy of an individual's financial information. However, we are concerned that the proposed regulation inadvertently curtails our ability to conduct business in an actuarially sound fashion, particularly with respect to the business of reinsurance[2].

Specifically, the proposed regulation could be interpreted as allowing individuals to remove their policies from the scope of the insurer's reinsurance arrangements. This could infringe upon the actuarial principles of risk selection and would negatively impact the ability of the reinsurance arrangement to achieve its strategic objectives (see the examples provided in Attachment 1).

To correct this, our recommended course of action would be for you to make the following change (new wording is underlined) in order to make the Section 216.10(a)(4) exception more explicit:

> "[The opt out does not apply if you disclose nonpublic personal information] in connection with a proposed or actual securitization, secondary market sale (including sales of servicing rights)<u>, reinsurance transaction,</u> or similar transaction related to a transaction of the consumer…"

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[1] The American Academy of Actuaries is the public policy organization for actuaries practicing in all specialties within the United States. A major purpose of the Academy is to act as the public information organization for the profession. The Academy is non-partisan and assists the public policy process through the presentation of clear and objective actuarial analysis. The Academy regularly prepares testimony for Congress, provides information to federal elected officials, comments on proposed federal regulations, and works closely with state officials on issues related to insurance. The Academy also develops and upholds actuarial standards of conduct, qualification and practice, and the Code of Professional Conduct for all actuaries practicing in the United States.

[2] Throughout this comment letter, by "reinsurance" we wish to exclude transactions of the type commonly referred to as "assumption reinsurance" wherein the contractual guarantee of a policyholder's benefits is legally transferred from one insurer to another.

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We now provide additional background to explain why we are making this recommendation.

In the absence of a specific regulatory exception, Section 216.7 of the proposed regulation requires that a financial institution wishing to disclose a customer's "nonpublic personal information" to an unaffiliated third party must not only inform the customer of the intended disclosure, but also give the customer the opportunity to "opt out" of that disclosure. Clearly a reinsurer cannot accept risk relating to a policy, even under an automatic treaty with the issuing insurer, without having received nonpublic personal information from the insurer.

If it were established that reinsurance did not fall under the scope of the exceptions outlined in Sections 216.9, 216.10 and 216.11, then the regulation could force an insurer to disclose to the policyholder its wish to reinsure some or all of the risks borne under the policy. More importantly, the regulation would then effectively grant to the policyholder the ability to remove his/her policy from the scope of any reinsurance treaty that would normally include the policy.

When an insurer decides to cede some or all of the risks for which it has contracted through the issuance of an insurance policy, that reinsurance arrangement is typically completely invisible to the policyholder. The existence of reinsurance does not in any way affect the nature of the issuing insurer's guarantee to the policyholder, and indeed it can often implicitly enhance the value of that guarantee by improving the insurer's financial condition. There is no legitimate need for the policyholder to be made aware that the issuing insurer has elected to cede some or all of the risks relating to his/her policy. In general, insurers do not disclose to policyholders of the existence of any reinsurance arrangements.

Our reading of the regulation leads us to believe that excepting reinsurance from the Section 216.7 disclosure limitations is consistent with the intent of the proposed rule and is arguably implicit in the regulation as currently worded. However, more explicit language to this effect is desirable. The Section 216.10(b)(2)(v) exception[3] mentions reinsurance, but may not be sufficiently broad in scope, since typically participation in an insurer's reinsurance program is not "a transaction requested or authorized" explicitly by the policyholder. The Section 216.11(a)(6) exception[4] clearly covers reinsurance transactions used to affect the sale of a block of business and its term "exchange" could be construed to cover all reinsurance transactions.

We appreciate that your objective in shaping Section 216.10 of the regulation was simply to mirror the language in Section 502(e) of the Gramm-Leach-Bliley Act. However, we believe that reinsurance is fundamentally similar to the transactions specifically named in Section 216.10(a)(4), and that the current phrasing of that subsection reflects a predominantly banking-oriented perspective that merits broadening to incorporate the corresponding issues arising from the insurance industry.

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[3] "The opt out … [does] not apply if you disclose nonpublic personal information as necessary to effect, administer, or enforce a transaction requested or authorized by the consumer … [where] 'necessary to effect, administer, or enforce a transaction' means that the disclosure is … required, or is a usual, appropriate or acceptable method … to underwrite insurance at the consumer's request or for reinsurance purposes…"

[4] "The opt out … [does] not apply if you disclose nonpublic personal information in connection with a proposed or actual sale, merger, transfer, or exchange of all or a portion of a business or operating unit…"

If you have any questions regarding our comments, please contact Damien McAndrews at 202-223-8196 or at mcandrews@actuary.org. We appreciate this opportunity to comment on the proposed privacy regulation.

Sincerely,

Stephen R. Kern, MAAA, EA
President

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Attachment 1 – Examples

- In general, the pricing of reinsurance is based on actuarial assumptions as to frequency and severity of claims, based on the corresponding assumptions made for the block of policies being reinsured. The fundamental connections between these two sets of assumptions would be thrown into disarray if an unknown proportion of policyholders, arguably having different risk characteristics in aggregate than the general population of policyholders, were allowed to opt out of the reinsurance. The overall efficiency of the reinsurance market would be adversely affected.

- Under a quota share reinsurance transaction, the insurer and reinsurer are said to "follow the fortunes" of one another since they each bear a proportion of the same risks; this mechanism aligns the interests of both parties. This alignment would be jeopardized by the creation of a set of policyholders whose risks remain solely with the insurer. If the experience of said set of policies differed considerably from the experience of the reinsurable policies, then the insurer could be forced into taking a set of actions that protect its own interests but act to the detriment of the reinsurer. This potential could impact the willingness of reinsurers to serve as a source of capital via quota share reinsurance.

- An insurer lacking expertise with a particular product but desiring a presence in that market for competitive reasons will often issue policies with the intent of ceding a significant amount of the risk on those policies to a reinsurer having expertise with that product. If policyholders were to opt out of the cession, then the insurer would be left with risks that it would be ill prepared to manage.

- Suppose that an insurer's intent in obtaining reinsurance is to protect itself from single catastrophic occurrences. It is important to note that the reinsurance only affords the desired immunization from catastrophe if it applies uniformly across the insurer's book of business. If a policyholder were to exercise a right to exclude his/her policy from the scope of the insurer's catastrophic cover, then the occurrence of a catastrophic claim under that policy would thwart the insurer's intent to insulate itself from the risk of such large claims.

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