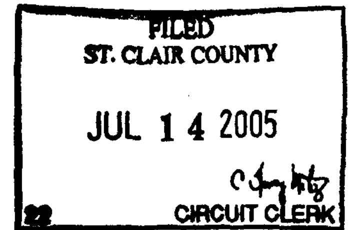
IN THE CIRCUIT COURT
TWENTIETH JUDICIAL CIRCUIT
ST. CLAIR COUNTY, ILLINOIS

JAMES E. TRUE, individually and on behalf of all others similarly situated, Plaintiff, v. UNITED SERVICES AUTOMOBILE ASSOCIATION, Defendant.	No. 04 L 79



AMICUS CURIAE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS' MEMORANDUM IN SUPPORT OF DEFENDANT UNITED SERVICES AUTOMOBILE ASSOCIATION'S MOTION TO DISMISS FIRST AMENDED COMPLAINT

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MEMORANDUM IN SUPPORT OF DEFENDANT UNITED SERVICES AUTOMOBILE ASSOCIATION'S MOTION TO DISMISS FIRST AMENDED COMPLAINT

The National Association of Insurance Commissioners ("NAIC") respectfully submits this memorandum as amicus curiae in support of Defendant United Services Automobile Association's Motion to Dismiss First Amended Complaint.

INTRODUCTION

This matter involves a class action lawsuit in which plaintiff alleges the Court should compel United Services Automobile Association ("USAA") to allocate its surplus to its members' Subscriber Savings Accounts. The NAIC is concerned the remedy sought may compromise legislated regulatory solvency considerations. The proposed remedy could consist of an accounting for reasonable capital and surplus in disregard of statutory accounting standards. This could have a significantly adverse, if not disastrous, impact on the ability of state insurance regulators to enforce solvency standards based on long-standing regulatory law and practice.

INTEREST OF THE AMICUS CURIAE AND SUMMARY OF ARGUMENT

The NAIC is a voluntary association of the chief insurance regulators in the 50 states, the District of Columbia, and four territories of the United States. As a private, not-for-profit corporation, the NAIC's purpose is to provide its members with a national forum for discussing common issues and interests and for working cooperatively on regulatory matters transcending the boundaries of their own jurisdictions. Collectively, commissioners work to develop model legislation, rules, regulations and white papers to coordinate regulatory policy. Their overriding objective is to protect consumers and help maintain the financial stability of the insurance industry.

The NAIC acts to support regulators in achieving fundamental objectives relating to insurance regulation, of which consumer protection is paramount. The impact of the potential remedy in this case, however, poses troublesome implications for insurance consumers, insurers and state insurance regulators that could extend well beyond the case at hand. Because it is the responsibility of state insurance regulators to protect consumers and to "promote the reliability, solvency and financial stability of insurance institutions," in the words of the NAIC mission statement, the NAIC asks to appear before this court.[1]

From the NAIC's perspective, the most significant factor in this case is how the relationship between insurers and policyholders is regulated in the United States. For more than 100 years, states have possessed the authority to regulate the business of insurance. In 1945 Congress codified the primacy of state regulation by enacting the McCarran-Ferguson Act, 15 U.S.C. §§ 1011-1015 (2000). Recognizing this longstanding regulatory system, the Court is obliged to carefully weigh the potential impact of its decision on the authority of state regulators to effectively regulate the solvency of insurers based on a long-standing statutory accounting and risk assessment framework.

Through the NAIC, state insurance regulators rely on each other to monitor the corporate affairs and financial condition of each state's domestic insurers. In this case, state insurance regulators face the precarious situation of having well-established statutory principles placed in jeopardy.

For purposes of this memorandum, the NAIC adopts USAA's statement as to the Standard of Review and Applicable Law. The NAIC takes no position on the underlying facts as alleged in the first amended complaint, but joins USAA in respectfully urging the court to dismiss the complaint.

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[1] NAIC Mission Statement, www.naic.org/about/mission.htm (last visited July 5, 2005).

ARGUMENT

The NAIC believes this case presents issues of great importance for state insurance solvency regulation. The judicial remedy sought in this case will potentially have a substantial impact on insurer solvency standards as applied by state insurance regulators.

THE NATIONAL SYSTEM OF STATE-BASED INSURANCE REGULATION REQUIRES THE DOMICILIARY STATE TO REGULATE AN INSURER'S FINANCIAL CONDITION.

In 1945, Congress placed responsibility for insurance regulation with the states by declaring "that the continued regulation and taxation by the several States of the business of insurance is in the public interest . . . ."[2] The McCarran-Ferguson Act further provides that "[t]he business of insurance . . . shall be subject to the laws of the several States which relate to the regulation or taxation of such business."[3]

State insurance regulators have carried out this legislative mandate by developing a complex and interdependent system of regulation, which applies to not only insurance companies but also insurance agents and related service providers. A primary method of regulating insurance companies is by monitoring their financial condition through examinations and other types of solvency surveillance. As insurers and their parent holding companies have grown increasingly national in scope, state insurance regulators, working through the NAIC and state legislatures, have built a system of financial regulation acknowledging the nationwide presence of large insurers such as USAA.

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[2] The Congress hereby declares that the continued regulation and taxation by the several states of the business of insurance is in the public interest, and that silence on the part of Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several states. 15 U.S.C. § 1011.

[3] The business of insurance, and every person engaged therein shall be subject to the laws of the several States which relate to the regulation of taxation of such business. 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, unless such Act specifically relates to the business of insurance . . . . 15 U.S.C. § 1012(a-b).

This system is based on the concept that an individual insurance company is primarily regulated for solvency by the state where its primary place of business is located-its domiciliary regulator. The other states in which the insurer has a presence rely on the domiciliary regulator's examination and analysis of the insurer's financial condition. It is this very reliance that is threatened when courts intervene in matters involving solvency regulation.

One program implemented along these lines is the NAIC Financial Regulation Standards and Accreditation Program.[4] By adopting a series of baseline laws, regulations, practice and procedures in conformance with duly adopted program standards, accredited states rely on the domiciliary state's solvency regulation in lieu of conducting redundant, and possibly conflicting, examinations and analyses of multi-state insurance companies.

Applying this general framework to the case at hand, USAA's domiciliary regulator is the Texas Department of Insurance. The insurance departments of other states where USAA is authorized to conduct business, including Illinois, rely on the domestic regulator's financial regulation of the insurer. Financial and solvency regulation includes the verification and oversight of capital and surplus requirements, the adequacy of which are the foundation of the plaintiff's complaint.

ANY REMEDY FASHIONED BY THIS COURT MUST BE CONSISTENT WITH SOLVENCY STANDARDS AS APPLIED BY STATE INSURANCE REGULATORS.

To the extent the plaintiff asks this court to substitute its judgment for the defendant's and domestic regulator's as to minimum capital and surplus requirements, the NAIC respectfully requests this court to refrain from doing so. Were an Illinois court to impose its determination as to capital and surplus on a non-Illinois-domiciled insurer, its decision could engender the type of

[4] *See generally* Accreditation Program Pamphlet, http://www.naic.org/frs/accreditation/docs/FRSA_pamphlet.pdf (last visited July 6, 2005) (containing general program information).

conflict the national system of state-based insurance regulation was designed to avoid. The case at hand is distinguishable from a dispute between an insurer and a policyholder as to coverage or claims handling because it focuses on a corporate decision—the allocation of surplus by USAA's governing board. Determining the adequacy of an insurer's surplus is within the business judgment of the insurer's board of directors, with the regulatory oversight of state regulators, who possess the expertise to interpret and apply solvency laws and regulations.

To help this court understand the complex and specialized nature of financial solvency regulation, some of the applicable requirements are described below. The laws of most jurisdictions establish specific and certain minimum capital and surplus requirements for domestic companies. Section 942.155 of the Texas Insurance Code sets forth the minimum surplus requirements for reciprocal insurance exchanges.[5] The plaintiff's first amended complaint alleges an appropriate reserve amount is $1.65 billion. The NAIC is unable to determine from the pleadings how this amount was calculated. In any event, it is important to note that statutory requirements establish merely the minimum level of surplus to be maintained. In the case of a large insurer such as USAA, it is prudent and practically essential to maintain surplus in excess of the statutory minimum. In fact, insurance regulators are required by law to look beyond the statutory minimum in assessing an insurer's overall financial condition.[6]

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[5] The minimum surplus to be maintained by a reciprocal insurance exchange, $1 million, is based on the minimum required for stock insurance companies. TEX. INS. CODE ANN. § 822.054 (West, Westlaw through 2005 Reg. Sess.). *See also* 215 ILL. COMP. STAT. 5/66 (West, Westlaw through 2005 Reg. Sess.) (setting forth minimum surplus amounts for reciprocals ranging from $150,000 to $2 million depending on when the company was organized and the line(s) of insurance being sold).

[6] TEX. INS. CODE ANN. § 822.210 (permitting the regulator to require surplus in excess of the statutory minimums based on several factors: (1) the nature and kind of risks the company underwrites or reinsures; (2) the premium volume of risks the company underwrites or reinsures; (3) the composition, quality, duration, or liquidity of the company's investments; (4) fluctuations in the market value of securities the company holds; or (5) the adequacy of the company's reserves). *E.g.*, 215 ILL. COMP. STAT. 5/186.1(2)(a) permits the regulator to order corrective action based on the company's failure "to maintain a relationship of policyholder surplus to premium writings or policyholder surplus to claim and unearned premium reserves."

Beyond the statutory minimum surplus level, it is the insurer, with the oversight of the domestic regulator, the Insurance Commissioner of the State of Texas, who is responsible for determining and maintaining reserves sufficient to ensure financial stability. Each company has a unique mix of underwriting risks, premium volume and investment value. Balancing and weighing these complicated factors is the responsibility of the entity most familiar with these factors—the insurance company.

The appropriate level of surplus to be maintained is a corporate decision governed by the business judgment rule. The business judgment rule provides that courts are to accord a presumption of correctness to the business decisions of a board of directors.[7] Absent allegations of personal interest, illegality or fraud, the business judgment rule precludes claims disputing the business decisions of a board of directors.[8] The NAIC supports USAA's argument that the business judgment rule applies to the plaintiff's remaining cause of action. As to the adequacy of the plaintiff's pleadings and allegations, the NAIC adopts USAA's argument.

The business judgment rule is properly applied in this case because the determination of adequate surplus levels is representative of an issue resolved by a corporate board with access to the entire landscape of the company's business. Among the many considerations in making such a determination include the quality and liquidity of assets/investments, reinsurance security, risk ratios, risk exposures and affiliated insurance and investment risks, which do not lend themselves to uniformity. The discretionary authority to determine the surplus required by company obligations, contractual or otherwise, resides first with the insurer's board of directors.[9]

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[7] *Cates v. Sparkman*, 73 Tex. 619, 623, 11 S.W. 846, 849 (Tex. 1889); *Pace v. Jordan*, 999 S.W.2d 615, 623-25 (Tx. App. 1999). *See also Stamp v. Touche Ross & Co.*, 636 N.E.2d 616 (1993).
[8] *Id.*
[9] *See* TEX. INS. CODE ANN. § 883.161; 215 ILL. COMP. STAT. 5/54.

The fact that the several states rely on the insurer's domiciliary state to determine reasonable surplus, beyond expressed minimums, is a direct result of the inherent variability of each company's needs. This statutory framework illustrates the fluidity that enables state insurance regulators to tailor solvency regulation to the characteristics of individual insurers.

A judicial determination of what should be a maximum surplus level for an insurer presents a substantial insurance risk. A distribution of surplus today only increases the risk of inadequate surplus in the future leaving insurers vulnerable to significant or possible catastrophic events in the future. The consideration of the dollar amount of the surplus, of known and unknown exposures, investment risk, risk from catastrophic losses and risks from potential failure of reinsurers are technically complex, particularly for a multi-jurisdictional, multi-line company which is why federal law assigns this role to the states severally.

The remedy sought in the pending proceeding may, if granted, be viewed as a de facto preemption of the authority granted by section 822.210 of the Texas Insurance Code, which permits the Insurance Commissioner to require surplus in excess of the statutory minimum. In other words, a financial award of sufficient magnitude could develop or create principles inconsistent with the well-recognized statutory accounting and risk assessment principles utilized and enforced by state insurance regulators. The NAIC is alarmed by the potential for judicial determinations of adequate capital and surplus to conflict with corporate determinations subject to regulatory oversight. Extraterritorial application of an individual state's laws in the area of financial regulation jeopardizes interstate reliance on the domiciliary regulator.

CONCLUSION

In the present case, there is the potential for a judicial determination of solvency standards, which are normally within the province of state insurance regulators. The NAIC

believes such a determination would have significant implications for consumer interests that have traditionally been protected by state insurance regulators as part of the executive branch of government. Solvency regulation has historically relied upon the considerable expertise of the domiciliary insurance regulator to regulate the financial affairs of its insurers no matter where such companies may do business. The NAIC therefore respectfully asks the Court to grant defendant USAA's motion to dismiss the plaintiff's first amended complaint because of the potentially significant impact of the proposed remedy on state insurance regulation.

Dated July 13th, 2005.

Respectfully Submitted,

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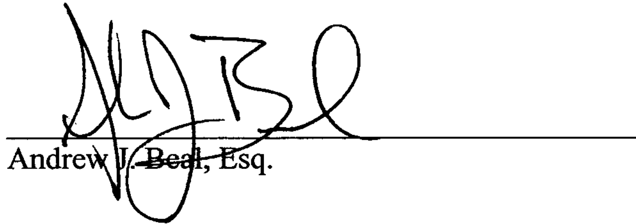
CERTIFICATE OF SERVICE

I, the undersigned, hereby certify that a copy of the foregoing Amicus Curiae National Association of Insurance Commissioners' Memorandum in Support of Defendant United Services Automobile Association's Motion to Dismiss First Amended Complaint was served to each of the following by prepaid, first class United States Mail on July 13, 2005.



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