International Insurance Implications
For Domestic Companies

I. Impact on Domestic Insurers

* States are adopting international standards under pressure
  - MHCA, ORSA, reins. collat., corp. gov.
* Additional costly layers of regulation
  ("hybrid"/hydra regulation)
* Small-mid sized insurers will have higher % costs and less political influence
* Market distortions including capital costs
**Regulatory Convergence in Banking**

Share of Total US Banking Assets Held by Five Largest Banks vs. Small Banks, 2000-2013

- 2000: 20%
- 2002: 30%
- 2004: 43%
- 2006: 46%
- 2008: 46%
- 2010: 18%
- 2012: 16%

Source: Bank of America Merrill Lynch, Federal Reserve Insurance Corporation

Definitions:
- Large banks - assets over $100 billion
- Intermediate banks - assets with $10 billion to $50 billion
- Small banks - assets below $10 billion

Analysis by Nick Bollos, Robert Davis, and Bill Schaefer, Federal Reserve at George Mason University

**Federal Insurance Office Staff**

No. of People

- May 2012: 2
- May 2013: 4
- Nov. 2013: 12
- Approved up to 15

June 2014: Fed hires senior insurance advisor
Nov. 2014: Fed hires additional staff with insurance expertise

II. Key Issues at Stake

- Global/One-size-fits-all/Bank-like IHC supervision
  - Centralized group supervision
  - Target capital
  - Implicit source of strength
- Reinsurance collateral
- IFRS accounting
  - Mark-to-market valuation of assets
  - Discounting/probability weighting of liabilities
- Increased Hydra regulation
- Corporate governance; market conduct; CEO remuneration
Concerns

• Increased consumer costs
  – Shapiro: $2.9-7.3b annually; HO+$45-109 just for CF
• Less competition, esp. smaller insurers (S&P+Fitch/SII)
• Transition costs in the billions
  – 76%: costs are disproportionate; 65%: value added
does not justify the expenses (Grant Thornton re SII)
• No need
  – U.S. p/c has record capitalization/surplus-premiums
• Increases systemic risk
• Shifts focus from protecting p/h to macroeconomic

III. What Went "Wrong"?
-- Pre-Financial Crisis

• Federal involvement formerly rare and issue
  specific (flood/TRIA)
• PCI and others able to stop federal regulation in
  Congress
  – Federal Reserve Board wanted supervision of
    large financial firms in all sectors during GLBA
    but only got "Fed-Lite"
• International Association of Insurance
  Supervisors (IAIS) started by NAIC to discuss
  best practices
Response to Global Financial Crisis

G-20/April 2009:
- "We face the greatest challenge to the world economy in modern times....A global crisis requires a global solution"
- "We agree to establish [a] framework of internationally agreed high standards that a global system requires"
- Action Plan: FSB created to "reshape our regulatory systems", support sustainable compensation and corporate responsibility, achieve global accounting standards

2009 U.S. Treasury: "Coordinate international financial policy through the G-20, the Financial Stability Board, and the Basel Committee on Banking Supervision"
- Stronger capital/solvency for all financial firms
- CFPB across the financial sector
- International reforms: higher capital, oversight & coordination, crisis prevention & management tools
- Office of National Insurance

Dodd-Frank Act

- Federal Reserve Board (FRB) given authority over 1/3rd of insurance:
  - Insurers with thrifts (SF, Nationwide, USAA, etc.)
  - Insurers designated as systemically important (AIG, Pru, Met)
- Federal Insurance Office (FIO) tasked with representing the U.S. at the International Association of Insurance Supervisors (IAIS)
- FSB, Treasury and European Union (EU) dominate the Financial Stability Board (FSB) and IAIS that set global insurance standards
- IAIS issues ICPs which cover all aspects of insurance regulation, are heavily based on Solvency II, are intended to apply to all insurers, with countries reviewed for compliance (FSAP)
Masters of the (Financial) Universe

- US/EU drive the Financial Stability Board
  - FSB dominated by banking
  - FSB demands centralized holding company regulation for insurance
  - FSB directs IAIS on global insurance standards
  - Fundamental shift from regulation of legal entities for consumer protection to regulation of holding companies to protect financial stability

Shifting Insurance Regulatory Fulcrum
Post-Financial Crisis

- Europe adopted Solvency II – based on central banking regulation that puts them at a competitive disadvantage if not globalized
- Treasury/FRB advocating global banking standards for similar reasons
- Treasury (FIO)/FRB joined IAIS, displacing NAIC influence
- FIO is kingdom building
- Treasury (FIO) and the FRB agreed internationally to name 3 U.S. insurers as SIFIs then made a parallel domestic ruling over the objections of FSOC's insurance experts

Today

- FRB/FIO/EU eliminated critical transparency in the process
- FIO is negotiating covered agreements that would preempt state reinsurance collateral and potentially increase the federal role
- The FRB is now deciding on insurance holding company regulations
  - HC capital, source of strength, accounting, stress testing, corporate governance,
- FRB/FIO may then make their rules part of the global standard, starting with international active insurance groups (IAIGs)
Insurers Subject to Central Standards

50%

- ISLHCs with Banks/Thrifts
- ISLHCs + SIFIs
- ISLHCs + SIFIs + IAIGs

Changing the Regulatory Paradigm

- U.S. state regulation is focused on legal entities/consumers
- Basel III/Solvency II rely on additional layers of centralized holding company regulation with much stricter failure tolerance (capital and supervision) because of greater systemic risk and weaker safety nets
- Bottom line:
  - HC capital/supervision/stress testing/IFRS (or adjusted GAAP)
  - Expanding source of strength
  - Increasing corporate governance (review of officers/board)
  - Much stricter ERM and resolution planning
  - Limits on officer remuneration
  - Market conduct
  - More government partnership/involvement with insurers
PCI Aggressive Engagement

- At the table in all major forums
- Congressional appropriations
- House/Senate bipartisan resolutions
- Congressional hearings/questions/letters/investigations
- St. dies/funded think-tanks
- Industry coalitions
- NAIC/NCOIL activism
- Working with all regulators/stakeholders

Congressional Oversight Agenda

- Treasury/FRB are exceeding their DFA authority
  - Especially internationally without Congressional approval, accountability or adequate transparency
- Treasury/FRB intrusion lacks proportionality and is not focused on protecting the U.S. system or consumers
- Concerns focused on:
  - FRB expansion
  - Treasury conflict with states/industry;
- Bipartisan interest but Ds want to protect DFA
Potential Legislation/Safeguards

- Clarify intent of Congress re primacy of state regulation, including in international negotiations on insurance
- Require FRB to narrowly tailor its insurance intrusion
- Require more studies, transparency, public comment
- Limit the ability of bank regulators to raid insurance assets

Conclusion

- 2015-2016 is a critical juncture before a majority of the U.S. insurance industry will start being subject to new centralized standards
- Extensive opposition has slowed but not stopped global regulatory convergence
- Congress and state legislators are increasingly concerned
- The insurance industry is somewhat split over next steps