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STATEMENT OF PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA

U.S. HOUSE FINANCIAL SERVICES COMMITTEE

ON

“The Impact of Domestic Regulatory Standards on the U.S. Insurance Market”

September 29, 2015

I. Introduction

Chairman Luetkemeyer, Ranking Member Cleaver and members of the subcommittee, the Property and Casualty Insurers Association of America (PCI) commends you for holding this important hearing on “The Impact of Domestic Regulatory Standards on the Competitiveness of U.S. Insurers” and appreciates the opportunity to provide testimony. PCI represents nearly 1000 insurers and reinsurers that provide virtually every type of coverage in the U.S. and around the globe. Our member companies include large, medium and small companies that through us work cooperatively with legislators and regulators to, as written in our mission statement, “promote and protect the viability of a competitive private insurance market for the benefit of consumers and insurers.”

PCI appreciates the leadership your subcommittee has shown in supporting the policy enunciated in the McCarran-Ferguson Act that the business of insurance should continue to be regulated by state insurance regulators who are most focused on protecting U.S. consumers and competitiveness. Now that the Dodd-Frank Act has established additional federal involvement in insurance, through limited roles by the Federal Reserve Board and the Treasury, your subcommittee is playing a helpful role in examining whether their involvement and new domestic or international insurance standards they are committing to will ultimately improve the competitiveness of the U.S. insurers and the marketplace.

The current U.S. regulatory system has produced the strongest, most competitive and largest insurance market in the world. While the U.S. share of the global banking market has hovered around 11-13%, roughly one-third of the world’s insurance premiums come from the U.S. and nearly half of the 50 largest insurance markets in the world are U.S. states. Over the past several years the property-casualty insurance industry has established record surplus and exceptionally low leveraging to safely support policyholder needs, and even in the depth of the recent financial crisis property-casualty insurance firms had very few insolvencies and outperformed the broader stock market in recognition of the financial safety of the industry.

Despite the exceptionally strong record of insurance regulatory success, the Federal Reserve, Treasury and state regulators have been under enormous domestic and international pressure to develop new holding company regulations. Congress with enactment of the Collins Amendment clarified its views that bank regulatory standards were not appropriate for insurance. The Fed, Treasury and state regulators remain deeply engaged in negotiating international efforts to consider imposing a global capital standard for insurance, which may not be appropriately designed for the business of insurance, particularly for U.S. insurers and some of the products they offer.

PCI recommends to the Committee's attention expert research papers by Drake University's Terri M. Vaughan and Cato Institute's Mark A. Calabria and Dr. Robert Shapiro, detailing the potential risks and monetary costs to U.S. consumers of a Basel/Solvency II bank-like regulatory system. Dr. Shapiro's study, "Unnecessary Injury: The Economic Costs of Imposing New Global Capital Requirements on Large U.S. Property and Casualty Insurers" for Sonecon, found that imposing Solvency II type capital standards on large internationally active US insurers would add nearly $100 every year to every home owner's insurance policy our consumers purchase. The Vaughan-Calabria study, "International Developments in the Insurance Sector: the Road to Financial Instability?" concluded that bank centric international standards might actually destabilize well-functioning insurance markets and actually create system risk by driving all insurers to adopting the same business models.

It is particularly critical for our U.S. representatives to the international agencies that are dictating financial policy to oppose new supervisory standards if they are not necessary and appropriate and in any event before the Federal Reserve has adopted appropriate risk measurements for the holding companies it supervises, which should be strongly tied to the proven existing state risk-based capital regime. Otherwise, instead of leading productive discussions towards mutual recognition of the U.S. system, our regulators and companies will be prejudiced by a harmful and potentially discriminatory global standard.

Congress has an essential and time sensitive role to play to buttress our U.S. state and consumer based regulatory system. Congressional oversight and legislation is both necessary and helpful to achieving coordination and consensus among the government entities involved, clarification of purpose and focus on consumers, and appropriate transparency and accountability in our domestic and international insurance engagements. The Subcommittee and full Committee have held a number of helpful hearings and several members of the House and Senate have introduced legislation that could potentially be very helpful. PCI urges strong action by the Committee on these issues.

II. The International Pressures Driving Changes in U.S. Insurance Regulation

Henry Ford once said "Any customer can have a car painted any color that he wants so long as it is black." The same one-size-fits-all philosophy is now being applied on a global basis to the insurance market with attempts to force all financial regulation into a bank-like system, losing the balance of consumer protection and competitive markets.

The focus on bank holding company regulation emanates from the Financial Stability Board (FSB). The FSB was based on an ad hoc body of central bankers, founded in 1999. During the financial crisis, the G-20 finance ministers and central bank governors formalized it and gave it nearly unlimited policy-making authority over all financial services, including insurance, without the benefit of Congressional debate or adequate transparency along the lines of what is required in the U.S. (e.g. open meetings and adherence to meaningful administrative procedures in the development and adoption of rules). Specifically, members of the FSB commit to "implement international financial standards" including "Insurance Core Principles, Standards, Guidance and Assessment Methodology." The FSB is chaired by a central bank, located in the Bank for International Settlements, composed primarily of central banks and finance ministers, and conducts its meetings largely behind closed doors. There is only one insurance specific member of the FSB (out of 70 members) – the International Association of Insurance Supervisors (IAIS), which itself is governed in part by numerous banking regulators. The US delegation to the FSB does not include any insurance regulators.

The FSB has exercised its self-generated authority across the entire length and breadth of insurance regulation. Under its leadership, the International Accounting Standards Board (IASB) has attempted to impose a mark to market international insurance accounting standard on the rest of the world (wisely rejected by the U.S.

Financial Accounting Standards Board), despite global market complaints about excessive costs and inefficiencies and the danger of increasing volatility and "short termism" even as it discourages much needed investment in infrastructure. The FSB has decided which bank and insurance companies had to be designated as systemically important (decisions that were subsequently implemented in the U.S. over the objection of domestic insurance experts and regulators). And the FSB has demanded adoption of increased central regulation of insurance with global capital requirements and a one-size-fits-all set of principles for resolution of financial entities, despite very different realities among the sectors.

The other largest insurance market in the world, Europe, responded to the financial crisis by approving Solvency II, a new regulatory system for insurers based in large part on the Basel international banking standards. While including numerous improvements over Solvency I, the new system is costing the insurance marketplace hundreds of millions of dollars to retool. Reflecting differences in the European and U.S. marketplaces and regulatory systems, Solvency II is heavily based on the use of capital to address regulatory concerns, and is focused at the top of the group to protect investors. For example, many European countries do not have comprehensive guaranty funds to protect policyholders and are more likely to have national champions with extensive activities, resulting in a greater focus on the need for additional capital to avoid the consequences of insolvencies.

Important European voices are questioning some aspects of Solvency II as it has evolved. Top among the contentious issues is the focus on mark-to-market accounting and the high levels of capitalization that some supervisors are requiring.

While Solvency II was still being developed, its group level and capital focus were migrated to global standards through the IAIS. Thus the global standards are largely a generic version of Solvency II. This poses a significant challenge to the U.S. which has a very different history, market context and regulatory system. Accordingly, most U.S. insurers and state regulators prefer mutual recognition of the best regulatory systems (including the U.S.) rather than mandating a single global regulatory model, especially if that model is based on another system that is significantly different from ours.

Current Priority Issues Arising Out of International Developments

Higher Loss Absorbency (HLA)

The International Association of Insurance Supervisors (IAIS) has committed to adopting strict holding company capital requirements (HLA) for systemically important insurers for the G-20 to approve by November 2015. And we note that the FSB has just approved an IAIS proposal. This is premature and could have very negative consequences for the companies subject to the HLA, along with consumers and markets.

There are many reasons why it is important to take more time on this issue. First, there is no global consensus on the formula or approach. Second, key definitions have not been agreed to, including what constitutes Non-Traditional/Non-Insurance (NTNI) activities. Third, the relationship to other capital standards is unclear. And fourth, imposing an unnecessary new capital mandate on some companies artificially creates competitive imbalances. It is critical for the Federal Reserve to complete development of its domestic standards for insurance holding companies it supervises before global commitments are made on an HLA. For all of these reasons, PCI believes that Congress should direct our U.S. representatives to the IAIS and FSB to oppose finalization of the HLA standards pending the successful resolution of a number of these fundamental issues.

Lack of Transparency and Exclusion of Key U.S. Players and Interested Parties

The FSB is increasingly the international locus of decision-making on all financial services regulatory issues. Yet the state regulators are not represented and insurance regulators over-all are under-represented at the FSB. The FSB makes its decisions behind closed doors and there is little if any consultation with the Congress or interested parties by U.S. delegation members before they advocate a position.

The IAIS, mimicking FSB procedures, recently voted to exclude interested parties from working group meetings, thereby restricting meaningful access by U.S. companies and consumers. This vote was taken with the approval of Treasury's FIO but against the votes of the NAIC and state regulators. The IAIS' new closed door procedures are out of step with the current trend toward greater transparency and with the procedures used by the NAIC where interested parties can observe and usually participate in working group and other meetings. PCI believes that all U.S. representatives should insist that transparency similar to that of the NAIC must be the rule in international forums considering insurance regulatory standards.

III. The Importance of Getting Our Domestic Standards Right

U.S. Capital Standards

In the congressional hearings and public forums leading to the enactment of the Insurance Capital Standards Clarification Act of 2014, an oft-repeated theme was that regulators should avoid using a one-size-fits-all approach to setting capital rules for financial companies under its jurisdiction. This was most typically reflected in the view that insurance companies should not be regulated like banks and subject to rules designed for banking.

There is significant international pressure to create a global capital standard for large internationally active insurers. If such a standard is appropriate and necessary, and many doubt that it is for the U.S. It is critical that the Federal Reserve and NAIC be allowed the time to get it right domestically so that the U.S. can lead international efforts towards mutual recognition. If international standards precede domestic standards, at best they create uncertainty and transition costs for impacted insurers while at worst they will establish harmful and anticompetitive regulatory burdens that will directly or indirectly pressure and influence a suboptimal domestic compromise.

PCI believes that the public is best served by proposals with the least additional cost, burden and complication when compared with the proven effective state-based standards in place today. No regulator has made a strong case or provided any consumer-focused cost-benefit analysis as to why direct holding company regulation is necessary for insurance companies, particularly when there is no source of strength doctrine applicable to insurance nor any possibility of a run on insurance companies.

However, to the extent that a domestic or international group capital measurement is established, state insurance regulators and PCI members strongly believe that the most efficient, effective and time-tested approach should be to aggregate existing state developed risk-based capital requirements for the legal entities. U.S. insurance risk-based capital (RBC) standards have been proven effective through many real world stress tests, including the financial crisis.

Last week, the NAIC's ComFrame Development and Analysis (G) Working Group decided unanimously to recommend that the NAIC develop a group capital calculation using the "RBC Aggregation Approach". PCI and the overwhelming majority of the U.S. industry support in concept the aggregation approach, as opposed to, for example, alternative statutory accounting consolidation or GAAP consolidation approaches. The Federal Reserve is similarly considering various alternative approaches. It is critical that the Federal Reserve coordinate

its approach appropriately with the states and consider the similar costs and benefits in its analysis, and that our U.S. representatives to the IAIS and FSB do not prematurely allow a global commitment to a conflicting HLA or ICS standard.

In addition, PCI suggests that any Federal supervision of insurance holding companies should be proportional to their risks to federal deposit insurance (in the case of insurance savings and loan holding companies) or their specifically identified systemic activities (in the case of SIFIs). PCI has had numerous insurance company members subject to Federal Reserve oversight divest their thrifts because by their calculation the cost of Federal Reserve oversight far outweighed any benefit that was being provided to consumers. Regulatory costs may decrease as the Board grows its insurance expertise and focuses its efforts. But policymakers have an appropriate role in clarifying the desired balance between trying to regulate for every possibility of failure versus facilitating a competitive and cost-efficient marketplace with a very strong safety net for consumers.

PCI believes that for the companies it regulates, the FRB should have the time it needs to do its work in collaboration with state regulators, which the end result should be an aggregation approach with the minimum change and that international standards should be delayed until that is done.

Designation and Regulation of Systemically Important Insurers (SIFIs)

The Dodd-Frank Act set forth a list of factors the FSOC is to consider when determining whether a nonbank is systemically important. However, FSOC's designation decisions regarding insurance groups has not provided a meaningful analysis of these factors, focusing instead primarily on issues relating to the size of the company and on hypothetical and arguably implausible scenarios under which material financial stress at the company would pose systemic risk to the economy. By declining to address the statutory systemic risk factors, the FSOC's designation decisions have not clearly established a coherent rationale for the decision based on activities in which the firm engages. This does not foster confidence in the FSOC's decisions. It also leaves all companies in the dark about what activities the FSOC considers systemically risky and thus provides no clear direction to companies on how to reduce systemic risk.

The Government Accountability Office (GAO), in a report released on November 20, 2014, also criticized FSOC for "using only one of two statutory determination standards (a company's financial distress, not its activities)" and noted that "FSOC may not be able to comprehensively ensure that it had identified and designated all companies that may pose a threat to U.S. financial stability."

FSOC's failure to address the ten specific "considerations" set forth in Dodd-Frank is particularly problematic with respect to recent insurer designations. One of those factors is the degree to which the company is already regulated by one or more primary financial regulatory agencies. State insurance regulation has a long-established, excellent record of protecting consumers against insurance insolvencies. Indeed, it could well be argued that its record is superior to that of numerous federal regulators who have regulated banks, savings and loans, and other financial firms. Despite this, the designations seem to assume that state insurance regulators would be unable or unwilling to respond effectively to problems in insurance companies. For example, the FSOC worried that financial troubles at a life insurer could lead policyholders to seek to surrender their policies in a disorderly manner, but the FSOC failed to acknowledge that state insurance regulators have the ability to impose stays or take other action to manage any such surrender activity. Congress recognized that state regulators have a number of options to mitigate systemic risk, but the FSOC has disregarded those tools. In exercising its oversight responsibilities, Congress should reaffirm its instruction that FSOC consider and provide an in-depth analysis of each of these factors in determining whether an insurer should be designated as systemically important.

FSOC's decisions to designate insurers as systemically important are particularly disturbing given that the decisions with regard to two were reached over the strong and substantive objections of both FSOC's

Independent Member Having Insurance Expertise and the non-voting State Insurance Commissioner Representative. The FSOC's decision record does not make clear why the strong views of these two insurance experts were disregarded and provides no substantive refutation to the informed and well-reasoned arguments of these experts. We view this as one of the surest signs that the FSOC designation process is flawed and in need of increased congressional oversight and reform. At a minimum, Congress should consider directing the FSOC to provide a well-articulated and substantive discussion of its rationale any time it disregards the expert advice of those on the FSOC who Congress put there to bring insurance expertise to the table.

A byproduct of the lack of clear rationales for FSOC designation decisions is that the FSOC has not provided a roadmap for how companies can take action to eliminate activities that pose systemic risk and thus become eligible to have a designation of systemic importance removed. The ultimate goal of the Dodd-Frank Act was to reduce systemic risk and it created the FSOC primarily to do so. By failing to specifically identify the systemically risky activities required to be addressed in companies it designates or to provide an "exit ramp" for such companies, the FSOC replaces an effort to reduce systemic risk with just another layer of federal control.

The FSB has now indicated that it will be considering additional insurers to designate as systemically important and has demanded that the IAIS change its systemic risk analysis accordingly. PCI believes that the U.S. SIFI designation process should be overhauled to be decoupled from any international process and to be more transparent, to provide deference on insurance issues to the insurance experts and to clearly provide for an exit ramp.

IV. Other Important Insurance Issues Before the House Financial Services Committee

HUD/disparate Impact

The Department of Housing and Urban Development issued a rule implementing disparate impact test on housing activities, specifically including homeowners insurance. McCarran Ferguson applies to federal agencies and HUD's incursion into state regulation will conflict, impair or supersede the laws and regulations established by states to protect consumers. Recently, the Supreme Court upheld the disparate impact test as a basis for liability under the Fair Housing Act. A federal district court, at PCI's request, remanded HUD's rule finding it is arbitrary and capricious under the Administrative Procedures Act partly on the basis that HUD failed to consider McCarran Ferguson. Imposition of HUD's rule could have significant negative consequences for domestic insurance markets and consumers.

Federal Data Collection

Various federal agencies subject to the Committee's jurisdiction have been amassing vast quantities of consumer transactional financial data. Some groups have been advocating that the Federal Insurance Office (FIO) in Treasury start imposing data calls on the insurance industry, particularly in the context of auto insurance and terrorism insurance. The Dodd-Frank Act and TRIA require FIO to first obtain data from the states and public sources where reasonably available before imposing new costs on insurers. Insurers are also very concerned about federal data security as this often sensitive consumer information is amassed. The federal government has had numerous known data breaches compromising personal information. PCI encourages Congress to work with the federal agencies to minimize the number and costs of data calls, ensure that data demands are coordinated with the states or appropriate data aggregators that can keep information confidential, and to avoid collection of any personally identifiable information.

Data Security

PCI strongly supports consideration by the Committee of national preemptive standards on data security and breach notification. PCI appreciates the current Committee consideration of expansion of the Gramm-Leach-Bliley Act functional regulator enforcement with an appropriate standard of actual harm. PCI has suggested some technical improvements, as well as focusing insurance enforcement through insurers' lead state regulator for consistency.

Raiding Insurers to Protect Banks

Bipartisan members of the Committee have introduced legislation supported by state insurance regulators to limit the ability of federal banking regulators to access insurer assets as a source of strength for banks, potentially robbing assets dedicated to insurance consumers to satisfy bank creditor demands. The legislation also makes a technical correction to the DFA regarding state insurance regulators' ability to rehabilitate insolvent insurers. PCI strongly supports this bipartisan legislation.

Allowing Lenders to Accept Private Flood Insurance

The Ross-Murphy Act (H.R. 2901) would clarify a provision in Biggert-Waters designed to provide consumers with a choice to purchase private flood insurance coverage and reduce lender reliance on federal flood coverage. PCI believes this is an important step in the right direction.

NARAB

The Administration is currently vetting potential nominations for the board of the National Association of Registered Agents and Brokers (NARAB) that Congress authorized earlier this year. NARAB would allow nationwide licensing for insurance providers with substantial state regulator control. PCI looks forward to working with policymakers to successfully get NARAB up and running.

Equivalence and Covered Agreements

The European Union has signaled its interest in providing temporary equivalence to the United States and our U.S. insurers under its Solvency II requirements in return for certain concessions in a covered agreement on foreign reinsurance collateral requirements. PCI expressed our views to the U.S. agencies involved regarding the importance of preventing discrimination against U.S. insurers, the potential danger spots in such an agreement including preemption of state regulation, and the need to coordinate with the state insurance regulators to achieve reasonable consensus on any regulatory changes that will required.

V. Conclusion: Congress Should Re-establish Its Policymaking Role in Support of the U.S. System to Ensure Prioritization of Consumers and Competition

As international and domestic regulatory developments gain in urgency and importance, it is vitally important that Congress re-establish its ultimate decision-making authority. Here are some critically needed actions by the Congress:

- Clarify the need for increased transparency and consultation with Congress and for all U.S. players to advocate international standards that are sufficiently flexible so as to recognize U.S. regulation by the Federal Reserve and states as at least one way to comply with the international standards;
- Clarify that the FSOC process needs reform including more transparency and an exit ramp;
- Evaluate the necessity and appropriateness of the need for any new and higher capital standards for U.S. insurers;
- Delay international capital standards, most immediately the HLA, until the U.S. has developed its approach;
- Make clear that all U.S. representatives need to work together to support least burdensome new standards in areas such as capital requirements (such as an RBC aggregation approach), including HLA;
- Emphasize the need to oppose standards that would have a negative effect on the U.S. markets and consumers;
- Prevent mission creep by federal agencies in terms of data collection and other regulatory functions that should remain the responsibility of the states; and
- Continue robust oversight and legislative consideration.

Several legislative proposals contain elements of these key points and we urge the Congress to enact them.