LEGISLATIVE PROPOSALS TO REFORM DOMESTIC INSURANCE POLICY

HEARING

BEFORE THE

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HOUSING AND INSURANCE

OF THE

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U.S. HOUSE OF REPRESENTATIVES

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LEGISLATIVE PROPOSALS TO REFORM DOMESTIC INSURANCE POLICY

Tuesday, May 20, 2014

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON HOUSING
AND INSURANCE,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2:05 p.m., in room 2128, Rayburn House Office Building, Hon. Randy Neugebauer [chairman of the subcommittee] presiding.

Members present: Representatives Neugebauer, Luetkemeyer, Royce, Garrett, Duffy, Stivers, Ross; Capuano, Clay, McCarthy of New York, Sherman, Beatty, and Horsford.

Also present: Representative Posey.

Chairman NEUGEBAUER. This hearing of the Subcommittee on Housing and Insurance entitled, "Legislative Proposals to Reform Domestic Insurance Policy," will come to order.

We will have opening statements, 10 minutes on each side, for the Majority and the Minority.

And there may be Members in attendance who are not assigned to the Housing and Insurance Subcommittee. Without objection, members of the full Financial Services Committee who are not members of this subcommittee may sit on the dais today, but, consistent with our committee policy, they may not be recognized or yielded to for any purpose. If they have any written statements, we will include them in the hearing.

At this particular point in time, I will give my opening statement.

Thank you for being here today. I think this is an important hearing. We are going to talk about five legislative proposals to reform the domestic insurance policy in this country. This hearing will give many of the stakeholders in this room much-needed respite from our TRIA deliberations.

And speaking of TRIA, I noticed that in the audience today, there are a few people here who may have a little bit of an interest in that subject. Just to give you a little bit of an update, we are working very hard on that issue.

Just a couple of weeks ago, as you may know, we sat down with some of the Members of the Majority who sit on the committee and we laid out a framework for them to review. And we opened up a dialogue and a discussion with those Members, and we have been getting some very valuable feedback.

And in the very near future, we plan to, once we make some refinements in that framework, sit down with the Minority, as well. Because it is our goal, hopefully sometime in June, to put out a bipartisan—hopefully, it will be a bipartisan bill on TRIA, to move out of this committee. And hopefully, we will then put it in the hands of leadership and let them determine when we might look at passing that on the House Floor.

But I just wanted to give you a little bit of an update. As many of you are seasoned veterans around here, you know it doesn't always go on schedule, but that is the schedule that we have today.

But today we turn our attention to some insurance reform legislation that focuses on protecting policyholders, offering more consumer choice for insurance products, and providing regulatory relief to reduce costs to domestic policyholders.

First, we will examine legislation which ensures that regulations intended to rein in certain activities of large complex financial institutions don't trickle down to insurance companies that are properly regulated at the State level.

H.R. 4510, which was introduced by Representatives Miller and McCarthy, would clarify that application of capital requirements to insurance companies that are subject to Fed supervision. This bill would simply ensure that capital standards intended for banks are not needlessly applied to insurers that own financial institutions.

H.R. 605, introduced by Mr. Posey, would make certain insurance companies not subject to Federal assessments to pay for the orderly liquidation of failed financial institutions, given that State insurance laws already govern the process for unwinding failed insurers.

Second, we will examine the legislation intended to protect insurance policyholders who are customers of a bank-affiliated insurance company. H.R. 4557, introduced by Mr. Posey, would allow State insurance regulators to intervene to protect the soundness of the insurance company affiliate with a failing financial institution. This will allow regulators to ring-fence insurance-specific assets so that policyholders are protected in the event of insolvency.

And finally, the subcommittee will examine two draft proposals intended to increase consumer choice and to reduce unnecessary regulatory burdens. The first, authored by Mr. Ross from Florida, would modify the Liability Risk Retention Act to allow self-insured liability risk-retention groups to create efficiencies by expanding their commercial lines of coverage. The second, authored by Mr. Stivers, would lessen the regulatory burdens associated with data requests from insurance supervisors.

I applaud all of the sponsors of these bills that we plan to examine today. And separately, I would like to acknowledge Mr. Duffy for all of his hard work he and his staff have done on the Miller-McCarthy capital standards bill.

I also would like to recognize Mr. Duffy, in that he just recently added another member to his family. I believe this is number seven. And it was a little girl, as I—

Mr. CAPUANO. Seven?

Chairman NEUGEBAUER. Yes.

Mr. DUFFY. I'm very productive.

Mr. CAPUANO. A little overproductive.

Chairman NEUGEBAUER. So, I look forward to a very productive hearing.

And now, I would like to recognize the ranking member of the subcommittee, Mr. Capuano, for 2½ minutes.

Mr. CAPUANO. Thank you, Mr. Chairman.

I want to thank the panel for being here.

I think there will be some good discussion today. I don't think there is going to be a lot of debate. There may be some basic issues. I think most of these issues that are proposed in these bills are reasonable and thoughtful. Again, there will be some details, but, overall, I am looking forward to some discussion to see if we can come up with easy ways to do some easy things without complicating them with unnecessary, extraneous material.

Thank you very much.

Chairman NEUGEBAUER. And now, I would like to recognize Mr. Duffy for 1½ minutes.

Mr. DUFFY. Thank you, Mr. Chairman, for holding this very important hearing.

And I appreciate the panel coming in and dispensing some of your wisdom and thoughts on the bills that we are talking about today.

I just want to say a few brief remarks about the Miller-McCarthy bill, a great bipartisan proposal, I think, that goes a long way to fixing a problem that I don't really think existed. We know the Fed interpreted the Collins Amendment differently than probably most everyone else in this room. And so we now have, I think, a bipartisan legislative fix that addresses that Fed interpretation.

Listen, I don't think anyone anticipated that we would apply bank capital standards to insurance companies. And that was never the intent of the Collins Amendment. The Miller-McCarthy bill will address that issue, making sure that we treat insurance companies very differently than banks in relationship to the capital which they are required to hold.

So, I look forward to your testimony and your views on all of the bills, but specifically in regard to Miller-McCarthy.

And I want to also extend my thank you to Mr. Miller and Mrs. McCarthy for their bipartisan effort in bringing out this proposal.

I yield back.

Chairman NEUGEBAUER. I thank the gentleman.

The gentleman from California, Mr. Sherman, is recognized for 2 minutes.

Mr. SHERMAN. Thank you.

We need to pass the reauthorization of TRIA. That isn't on the agenda today.

We saw with AIG an excellent case study. That portion of the enterprise that was subject to State insurance regulation remained healthy even though the top managers in the company were behaving like drunken sailors. Those parts of the company that were not subject to State insurance regulation crashed as if they were being run by drunken sailors.

The other thing this proves is that credit default swaps are insurance and should be treated as such. And we probably would not have had a 5-year catastrophe in our economy had we done two

things: one on the credit rating agencies; and the other is to require that portfolio insurance be called insurance.

We are dealing with a number of bills today, two that are important and that I am happy to cosponsor.

One is the Miller-McCarthy provision, summarized by the last speaker. And that is that we need to use insurance accounting principles to determine the creditworthiness of insurance companies.

The second, the Policy Protection Act, introduced by Mr. Posey, and I guess I am the chief Democrat on it, recognizes that you should not invade an insurance company and seize assets in a way that endangers its policyholders simply to shore up a related and affiliated bank or other depository institution. What the bill does is it takes the policyholder provisions that are already in the Bank Holding Company Act and puts them also in the Thrift Holding Company Act.

And, with that, my time has expired.

Chairman NEUGEBAUER. I thank the gentleman.

And now, another gentleman from California, Mr. Royce, is recognized for 2½ minutes.

Mr. ROYCE. Thank you. Thank you, Mr. Chairman.

And just a reminder for my friend from California, that the securities lending operation of AIG was regulated at the State level.

But this hearing on legislative proposals to reform domestic insurance policy confirms a new normal for insurance regulation in the United States. It is basically a hybrid model with layered regulation by States and the Federal Government. The age-old debate of State versus Federal regulation is aged, is old. The new reality involves State regulators, it involves the Federal Reserve, and it involves the Treasury Department, both through the Financial Stability Oversight Council (FSOC) and through the Federal Insurance Office (FIO).

Many of the bills before us today are a response to this hybrid model. In particular, H.R. 4510, the Insurance Capital Standards Clarification Act, offered by the gentleman from California, Mr. Miller, reflects a belief that insurance capital standards set by a traditional bank regulator, the Federal Reserve, need not be bankcentric and should, in fact, be tailored to reflect the unique and specific business model of insurance companies.

I strongly support this bill. Regulation can take place at the Federal level, but it must be smart and specific to insurance operating models. And without changes, the current hybrid insurance regulation structure has the potential to fail consumers miserably.

A system which produces regulatory confusion, hinders consumer choice, and discourages competition is burdensome for all parties involved. And I have said this before: It very well may be that the system has not failed, but since when has nonfailure been a synonym for success?

Unlike some of my colleagues, I believe much of the problem is lack of uniformity at State levels. Within this hybrid framework, we should effectuate uniform domestic regulations. And toward this end, yesterday, along with Representative Tammy Duckworth, I introduced the Servicemembers Insurance Relief Act of 2014, a

straightforward bill to ensure portability of auto insurance for all our servicemembers, who often move from State to State.

This bill is a perfect example of a simple fix to the insurance regulatory framework that will make a big difference in the lives of American consumers. And I am hopeful this committee will move our new system of insurance regulation forward. We should start with immediate passage of H.R. 4510.

Thank you very much, Mr. Chairman.

Chairman NEUGEBAUER. I thank the gentleman.

I now recognize the gentlewoman from New York, Mrs. McCarthy, who is one of the primary authors of H.R. 4510, and has worked tirelessly on this issue. I thank her for her work. And she is recognized for 2 minutes.

Mrs. MCCARTHY OF NEW YORK. Thank you, Mr. Chairman. I appreciate you holding this hearing, and I thank my ranking member.

I want people to know that when we did the Dodd-Frank Act, the bill that came out of this committee did not bring the insurance companies in. That was done over on the Senate side. And Senator Susan Collins of Maine has stated publicly now that she never intended to have bank capital standards apply to insurance companies.

Our bill—mine and Mr. Miller's from California, who unfortunately could not be here today—H.R. 4510, this bill which I sponsor will help keep insurance products affordable and available by ensuring the correct capital standards are applied to insurance companies that fall under the supervision of the Federal Reserve.

The intention was never to have them involved with this. This legislation will give the Federal Reserve more flexibility and help clarify the difference between the business of insurance and the business of banking.

The legislation starts from the premise that applying the wrong capital standards, such as bank capital standards, to an insurance company is ineffective, disruptive both to the insurance company and its policyholders. In the absence of this legislation, the Federal Reserve has said it will be obligated to apply bank capital standards to insurance companies under its supervision.

Since the insurance business model is so fundamentally different than the bank business model, those bankcentric capital standards would be very problematic for insurers and the many families and retirees who are their policyholders.

As I have mentioned, Senator Collins, the original author of the amendment, is sponsoring it on the Senate side with the correction, exactly the same as this legislation is. She will be cosponsoring it with Senator Brown and Senator Johanns. I am pleased to support this commonsense legislation which will play an important role in preventing future financial crises.

And I apologize. I had a root canal this morning, so I am still a little bit numb.

With that, I yield back.

Chairman NEUGEBAUER. I thank the gentlewoman.

And now the gentleman from New Jersey, the chairman of our Capital Markets Subcommittee, Mr. Garrett, is recognized for 1½ minutes.

Mr. GARRETT. Thank you.

And, first, I want to begin by thanking the chairman for holding this important hearing to examine various proposals to reform the domestic insurance policy. But I would also like to thank all of our witnesses for serving on today's panel.

July will mark the fourth anniversary of Dodd-Frank. And it is not surprising that in the nearly 4 years since Dodd-Frank became law the committee has had to consider a number of fixes to help clean up the regulatory mess that Dodd-Frank created.

Now, one of the law's most recent messes concerns the Fed's application of bank-like capital standards to insurance companies. And under Dodd-Frank, the Federal Reserve is required to impose minimum capital requirements on the companies it supervises, including insurance companies that own savings and loan associations and insurance companies deemed systemically important.

However, insurers face very different capital structures than banks, and, as such, it would make sense that the Fed should not treat insurance companies in the same manner when it comes to assessing these capital requirements. Unfortunately, the Fed maintains that Dodd-Frank requires the application of bank-like standards, even though Congress never intended such a standard to be applied to these companies under the Fed's jurisdiction.

So we have the Insurance Capital Standards Clarification Act now before us, and this would clarify that the Fed is not required to apply inappropriate standards to insurance companies that are already subject to appropriate State-based or foreign capital requirements.

See, at the end of the day, inappropriate regulations hit our families and small businesses in the pocketbook, so I hope that this hearing highlights the need for yet another round of Dodd-Frank cleanup.

I yield back.

Chairman NEUGEBAUER. I thank the gentleman.

And now one of our newer members to the committee, Mr. Horsford from Nevada, is recognized for 2 minutes.

And welcome to the committee.

Mr. HORSFORD. Thank you very much, Mr. Chairman. And thank you to Ranking Member Capuano.

If I may take just a moment, I would like to start by saying that it is an honor and a privilege to serve on the Housing and Insurance Subcommittee.

During the recession, my home State of Nevada suffered the highest rate of foreclosures in the Nation. And within my State, the congressional district that I represent was the hardest-hit. For my constituents, housing remains a top priority as we continue down the path to economic and financial recovery, so I am glad that we are holding a hearing on the five insurance bills before us today.

But I am also a little disappointed that TRIA is not on that list. Before coming to this committee, I served on the Committee on Homeland Security. There I heard firsthand from businesses and employers on the importance of having access to affordable terrorism risk insurance. These job creators have told me that this insurance provides a safety net which allows them to invest in growth without fear of losing it all due to an act of terrorism.

Most importantly, terrorism risk insurance reduces taxpayer exposure by confining most of the costs to the private sector. Without affordable terrorism insurance, many buildings, schools, and venues would remain uninsured against terrorist attacks, meaning that the government likely would pick up 100 percent of the tab for catastrophic losses.

So, I look forward to working with the members of this subcommittee to move forward on these important issues. And, again, I am very honored to be joining this committee, and I look forward to the work ahead.

Chairman NEUGEBAUER. I thank the gentleman.

The gentleman from Florida, Mr. Ross, is recognized for 1½ minutes.

Mr. ROSS. Thank you, Mr. Chairman, and thank you for holding this hearing.

Thank you, also, to our distinguished panelists for being here today and for your testimony.

My discussion today is over my draft that aims to modernize the Liability Risk Retention Act and allows established risk retention groups, also known as RRGs, with adequate capital and surplus to offer to their members, and only their members, the inclusive commercial insurance packages that are the norm in today's commercial marketplace.

Nationally, more than 25,000 educational, charitable, and Catholic institutions benefit from commercial liability coverage through an RRG. In my home State of Florida, more than 127 nonprofit organizations enjoy tailored liability coverage provided through an RRG, the alliance for nonprofits for insurance. These community organizations do important work for our society, and any penny they can save on insurance costs means one more penny they can spend on their charitable efforts.

My draft is targeted legislation that would provide these customers with the convenience of one-stop shopping with an insurance group they trust and of which they are a member. My draft seeks to address some of the previous concerns about this expansion. And I look forward to today's discussions from all of our witnesses.

In addition, my colleagues today have brought important bills for our discussion. I was pleased to cosponsor Representative Gary Miller's bill, which would allow the Federal Reserve to tailor capital standards to the business models of insurance companies.

We must ensure that Federal regulation of insurance companies is properly crafted and does not result in increased costs for consumers. Floridians already struggle with the cost of insurance. I want to make sure that the Federal Government does not worsen that burden.

I yield back.

Chairman NEUGEBAUER. I thank the gentleman.

And now, the gentlewoman from Ohio, Mrs. Beatty, is recognized for 2 minutes.

Mrs. BEATTY. Thank you, Mr. Chairman, and Ranking Member Capuano.

And thank you to our witnesses for their testimony here today.

This afternoon, we meet to discuss a series of legislative proposals that amend both longstanding and recently passed laws impacting the operation of insurers in the United States. However, none of these bills in any way addresses the expiration of the Terrorism Risk Insurance Act, which is slated to expire in just over 6 months.

I, and other Members on both sides of the aisle, believe that it is absolutely critical that we reauthorize this program in a timely manner so that insurers and insureds can renew their terrorism policies in a way that prevents lapses in coverage.

It is clear that failing to do so would risk a complete pullout from the markets by these property and casualty insurers, which would be catastrophic for the real estate recovery and for the ability of companies to provide terrorism liability coverage for workers' compensation claims, which in many States is required by law.

A recent study by the RAND Corporation found that premium increases in workers' compensation insurance may be insufficient to offset terrorism exposure.

Mr. Chairman, I urge you to work with members of this subcommittee, as well as members of the full committee and the House to bring a TRIA reauthorization vehicle through markup to the House Floor post haste. It is not just a matter of helping insurers but, more importantly, helping the American economy as a whole.

Thank you, Mr. Chairman, and I yield back.

Chairman NEUGEBAUER. I thank the gentlewoman.

And we will now hear from our witnesses.

We have five distinguished witnesses today: Mr. Joe Carter, who is vice president of business development and marketing for United Educators; Mr. Gary Hughes, executive vice president and general counsel for the American Council of Life Insurers; Mr. Tom Karol, Federal affairs counsel for the National Association of Mutual Insurance Companies; Mr. Joseph Kohmann, chief financial officer and treasurer of the Westfield Group, on behalf of the Property Casualty Insurers Association of America; and Professor Daniel Schwarcz, associate professor of law at the University of Minnesota Law School.

Your written testimony will be made a part of the record. We ask you to summarize that in 5 minutes, and then we will move to the question-and-answer portion of the hearing.

Mr. Carter, you are recognized for 5 minutes.

STATEMENT OF JOE E. CARTER, VICE PRESIDENT, UNITED EDUCATORS INSURANCE

Mr. CARTER. Thank you, Chairman Neugebauer, Ranking Member Capuano, and members of the subcommittee. Thank you for this opportunity to testify in favor of the Risk Retention Modernization Act of 2014, which will allow established risk retention groups to offer additional forms of commercial insurance coverage to their members. We have also submitted a written statement for the record.

I am Joe Carter, vice president of United Educators Insurance, a reciprocal risk retention group. And I am testifying on behalf of United Educators, as well as the Alliance of Nonprofits for Insurance Risk Retention Group, also known as ANI, and the National

Catholic Risk Retention Group, Inc. We are pleased that VCIA and RIMS, the leading trade associations for captives and risk managers also support this bill.

United Educators, ANI, and National Catholic owe their existence to the Liability Risk Retention Act of 1986. Congress was correct in assuming that risk retention groups would add capital to the insurance market, successfully moderate insurance pricing, and provide a stable source of insurance coverage for universities, nonprofits, professionals, and small businesses.

In the 25-plus years since the 1986 Liability Risk Retention Act amendments, more than 250 risk retention groups have aggregated more than $2.5 million in gross written premium. According to the rating agency A.M. Best, the focused approach of risk retention groups has resulted in aggregate operating performances that are "consistently better than that of their peer group in a commercial insurance market."

Many nonprofits, small schools, churches, and small businesses buy packaged policies that RRGs cannot write today. Many of these entities are therefore forced to forgo the coverages and more specifically, to tailor risk management services that risk retention groups give to buy their policies outside of risk retention groups.

If RRGs truly were only a response to a crisis and capacity for liability insurance, the member counts would surely have shrunk when the insurance industry came back into the market. Instead, risk retention groups have demonstrated that for certain types of similar organizations, collectively insuring each other is superior to relying on the traditional insurance sector.

As member-owned entities, risk retention groups provide where they proactively address coverage realities through risk-based research, actuarial-based pricing, and coverage levels that are designed to be sustainable. And any resulting profits are passed back to the members who own us, keeping their operating expenses down.

Our bill, which will permit seasoned risk retention groups to write other lines of commercial insurance, would bring more capital and more purchaser choice to the property and casualty market. However, not all risk retention groups could write other lines of commercial insurance if this bills becomes law. Instead, to write other lines, a risk retention group must be seasoned, meaning it must be licensed by the domiciliary State regulator and operating as a liability risk retention group for 5 years. They must also meet a minimum threshold capital requirement of $5 million and meet any other requirements that their State domiciliary regulator would require. This bill will not upend the Risk Liability Retention Act at all.

Let me tell what you what the Liability Risk Retention Act Modernization legislation will not do. It does not authorize risk retention groups to offer personal lines of insurance or write group health, life, disability, or Workers' Compensation insurance. It does not alter any rights of nondomiciliary States. And it does not change a risk retention group's responsibility to comply with State laws on deceptive practices or unfair claims practices.

In fact, one significant thing has occurred recently to strengthen State regulation of risk retention groups since the legislation was

introduced: RRGs are now subject to the NAIC State accreditation standards. Thus, RRGs are now subject to the same solvency standards for State accreditation purposes as other insurance companies.

The amendments proposed to the Liability Risk Retention Act by this modernization legislation will simply permit risk retention groups to offer their members, and only their members, the same comprehensive commercial insurance packages that are the norm in today's marketplace while benefiting from the customized risk management services that we are offering today.

In closing, risk retention groups have dramatically improved risk management and provided tailored coverages for specialized niches like nonprofits and educational institutions. And modernizing this Act would allow us to more effectively and efficiently continue this important work, which will allow them to continue to focus on the things that they are—their mission driven.

I thank you very much.

[The prepared statement of Mr. Carter can be found on page 38 of the appendix.]

Chairman NEUGEBAUER. Thank you.

And now, Mr. Hughes is recognized for 5 minutes.

STATEMENT OF GARY E. HUGHES, EXECUTIVE VICE PRESIDENT AND GENERAL COUNSEL, AMERICAN COUNCIL OF LIFE INSURERS (ACLI)

Mr. HUGHES. Chairman Neugebauer, Ranking Member Capuano, and members of the subcommittee, I appreciate the opportunity to provide you with the views of the American Council of Life Insurers on legislative initiatives addressing the way in which insurance is regulated in the United States.

I would like to confine my remarks this afternoon to a single issue that is of paramount importance to life insurance companies, and that is the need to provide the Federal Reserve Board with the flexibility it believes it needs in order to apply insurance rather than bank capital standards to those insurance groups that now fall under its jurisdiction as a result of the Dodd-Frank Act.

Dodd-Frank requires the Fed to apply consolidated capital standards to those insurance companies that are determined by FSOC to be systemically important and also to those insurers that control savings and loan institutions. Two of ACLI's member life insurance companies have been designated as systemically important financial institutions (SIFIs), and one additional company is under review for possible designation. Eleven of our member life companies are affiliated with S&Ls. And taken together, these companies account for approximately 30 percent of the insurance premiums of ACLI's overall membership.

But differently, a very significant segment of the life insurance business is now going to have its group capital standards set by the Federal Reserve. But beyond having a direct effect on these companies, the Fed's determination with respect to U.S. insurer group capital standards could very well be a precedent against which all insurers are measured, since it would affect such a large segment of the market.

It could also be a bellwether for similar standards being developed by international standard-setters. The global competitive in-

terests of U.S. insurers demands that every effort to be made to harmonize these emerging capital standards.

The good news here is that the Fed appears to recognize that applying bank capital standards to a life insurance enterprise would be wholly inappropriate and could materially disrupt the company's operations. The frustration, as you all have mentioned, is that the Fed believes the wording of Section 171 of Dodd-Frank doesn't give it the latitude it needs to apply insurance-based standards.

Now, to its credit, the Fed has temporarily exempted or deferred application of its capital rules to those insurance groups, thereby giving Congress time to clarify Section 171. But this is only a temporary respite, hence, the urgency for congressional action.

We are very encouraged by the fact that Congressman Miller and Congresswoman McCarthy—and, Congresswoman, thank you very much for your leadership on this—have sponsored H.R. 4510, the Capital Standards Clarification Act of 2014. And we would also note and thank the fact that a majority of the members of this subcommittee are cosponsors.

And thanks to you as well, Mr. Chairman, for your support.

This bill would provide the Fed with the very flexibility it needs to craft capital standards suitable in the context of an insurance company. Also, as you all have mentioned, Senator Collins, the original architect of Section 171, has made it clear that she never intended for the Fed to apply bank standards to insurers. And she, along with Senators Brown and Johanns, are advancing a bill similar to H.R. 4510 in the Senate.

To be clear, the insurance industry is not trying to sidestep the application of strong capital standards as mandated by Dodd-Frank. We are simply working to ensure that at the end of the day, the applicable standards are predicated on a framework appropriate for the business of insurance, such as the existing insurer risk-based capital system. This is a system specifically designed by insurance regulators for insurance entities and is a comprehensive and accurate measure of these companies' unique risks.

In summary, Mr. Chairman, ACLI's legislative priority in the House is passage of H.R. 4510. We believe it is imperative that the Fed be afforded the flexibility to utilize insurance-oriented capital standards for those insurance groups under its supervision. Substituting bankcentric standards would harm the affected companies, undermine rather than strengthen the supervision of insurers, and would be completely at odds with efforts to enhance the stability of the U.S. financial markets.

We look forward to working with this subcommittee and with both Houses of Congress to pass this important piece of legislation. Thank you.

[The prepared statement of Mr. Hughes can be found on page 55 of the appendix.]

Chairman NEUGEBAUER. Mr. Karol, you are now recognized for 5 minutes.

STATEMENT OF TOM KAROL, FEDERAL AFFAIRS COUNSEL, NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES (NAMIC)

Mr. KAROL. Chairman Neugebauer, Ranking Member Capuano, and members of the Housing and Insurance Subcommittee. I would like to thank you for holding this hearing entitled, "Legislative Proposals to Reform Domestic Insurance Policy."

My name is Thomas Karol. I am the Federal affairs counsel for the National Association of Mutual Insurance Companies. We are the largest property casualty insurance trade association in the country, serving regional and local mutual insurance companies on Main Streets across America as well as many of the country's largest national insurers. The 1,400 NAMIC members' companies serve more than 50 percent of the automobile and homeowners market and 31 percent of the business insurance market.

We are pleased that the committee is focusing on the issues related to property casualty insurance industry, which is highly competitive, well-capitalized, and is a key source of strength and resilience for the U.S. economy.

Our industry ensures the property casualty risks of the United States businesses and consumers, enabling the U.S. economy to thrive. It is imperative that we do not impede this well-functioning marketplace. NAMIC appreciates the opportunity to offer our comments.

The most important proposal to NAMIC members is H.R. 4510, the Insurance Capital Standards Clarification Act. The Act would afford the Federal Reserve greater flexibility to apply accurate capital standards for insurers by amending Section 171 of the Dodd-Frank Act to clarify the application of capital requirements to insurance companies subject to the supervision of the Federal Reserve Board.

There is widespread agreement that such flexibility is warranted and necessary. Senator Susan Collins of Maine, the author of Section 171, has made it clear that she never intended to have bank capital standards apply to insurance companies. The Senator and a number of Members of the House and Senate have urged the Fed to adjust the capital standards for insurance companies to align with the business of insurance, rather than the business of banking. Despite this, the Fed maintains that it is constrained by the language in Section 171.

H.R. 4510 resolves this question and acknowledges the fact that bank capital standards are not appropriate for insurance companies. It also recognizes the importance and appropriateness of statutory accounting principles. H.R. 4510 provides that the Fed may not use Section 171 to require insurance companies that are only required to prepare financial statements in compliance with State-based statutory accounting rules to also prepare financial statements under generally accepted accounting principles (GAAP).

Forcing such companies to prepare additional GAAP statements is a labor-intensive, multiple-year project that would cost policyholder owners hundreds of millions of dollars without adding any benefit in regulating the solvency and activities of the companies.

Similarly, NAMIC supports the Insurance Consumer Protection and Solvency Act of 2013, or H.R. 605, which clarifies that the

FDIC does not have the authority to assess insurance companies for the Orderly Liquidation Fund. The existing State-based resolution authority for insolvent property casualty insurers has a superb track record of protecting insurance claimants and policyholders at no cost to the taxpayer. Property/casualty companies and mutual companies in particular present almost none of the risk factors the FDIC is statutorily required to consider.

All insurance companies already meet guaranty fund obligations for the insolvencies in their own industry and should not be assessed the cost of failures in other parts of the financial services sector.

Both of these bills recognize that the business of insurance is fundamentally different than the business of banking, and that applying initial bankcentric regulations is inappropriate and damaging to the business of insurance.

NAMIC also supports the Policy Protection Act of 2014. The laws governing thrift holding companies do not provide the same procedural protections as the Bank Holding Company Act to ring-fence the assets of insurance subsidiaries for the protection of insurance companies.

The Policyholder Protection Act of 2014 simply amends the Bank Holding Company Act to provide the same protections for insurance companies organized as thrift holding companies.

Tapping the assets of insurance units, particularly without the consent of the insurance regulator, would inappropriately threaten the financial structure, underpinning the insurance operations and undermining consumer confidence in the insurance industry. To protect America's insurance consumers, the Bank Holding Act protections should be extended to thrift holding companies, and NAMIC supports H.R. 4557.

Finally, NAMIC supports the Insurance Data Protection Act, which would elevate the Federal authority to subpoena information directly from insurance companies to the Secretary of the Treasury, but also strengthen the confidentiality protections for the information and require reasonable reimbursement for the cost of compliance with the data protection. The Insurance Data Protection Act would not deny the Federal Insurance Office or the Office of Financial Research any relevant information or impede their functions but would ensure that they take reasonable steps to prevent unnecessary and duplicative reporting by insurance companies. In fact, the legislation would afford insurers many of the protections recently highlighted in the Administration's big data and privacy work group review.

I want to thank the subcommittee again for holding this important hearing and for providing NAMIC with the opportunity to discuss these legislative proposals. I look forward to your questions.

[The prepared statement of Mr. Karol can be found on page 63 of the appendix.]

Chairman NEUGEBAUER. I thank the gentleman.

Mr. Kohmann, you are now recognized for 5 minutes.

STATEMENT OF JOSEPH C. KOHMANN, CHIEF FINANCIAL OFFICER AND TREASURER, WESTFIELD GROUP, ON BEHALF OF THE PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA (PCI)

Mr. KOHMANN. Thank you, Mr. Chairman, Ranking Member Capuano, and members of the subcommittee.

I am testifying on behalf of the Property Casualty Insurers Association of America (PCI), which is composed of nearly 40 percent of the Nation's home, auto, and business insurers. My name is Joseph Kohmann, and I am the chief financial officer and treasurer of the Westfield Group.

Westfield as midsized insurance company that has been in business for over 166 years with an A or higher A.M. Best rating for the past 75 years. We provide over 2,200 direct jobs in 31 States, partner with thousands of independent insurance agents to serve our customers, and are one of the top writers of farm business in the United States.

Westfield also owns a community bank that originates roughly $300 million in loans annually, predominantly to owner-operated small businesses and individuals. We are not a Wall Street institution, but a very important regional provider of insurance and banking services to middle America.

Both PCI and Westfield support strong regulation. But our growth is being restrained by unintended consequences stemming from an expansion of banking regulation in the Dodd-Frank Act that conflicts with State insurance regulation. For example, the Dodd-Frank Act requires the Federal Reserve Board to impose the strictest bank capital standards on insurance holding companies with a depository affiliate, even just a small community bank.

Westfield's business activities are primarily insurance. The measurements used to determine capital and leverage ratios for banking are completely different than those used to govern auto insurance or farm insurance.

A strict application of bank capital requirements to our insurance activities just does not make sense.

The Federal Reserve Board agrees. They recognize that insurance and banking operate with completely different business models. They have delayed implementation of the requirement until Congress can act. But not for long. Dozens of Members of Congress, including Senator Collins, who authored the original legislative requirement, have written to the Federal Reserve Board saying that this application of bank regulation to insurance is inappropriate.

Fed Chair Yellen testified under questioning that this is an unintended consequence of the Act. Yet, the Board says they do not have the statutory flexibility to provide relief unless Congress acts.

Please pass H.R. 4510 to help Senator Collins clarify the intent of her original amendment and to allow the Federal Reserve Board to apply appropriate capital standards to insurance companies.

PCI strongly supports the other bills before the committee as well. H.R. 605 ensures that resolution of insurance companies and their assets is conducted by insurance regulators, not by a Federal banking agency. It would also prevent the FDIC, which is primarily responsibile for bank resolutions, from using insurance assets to support failing banks. Insurers are already responsible for resolv-

ing their own failures and pay for guaranty funds in every State to protect consumers. Do not let insurance policyholder protection funds be used to support risky investment firms and banks.

H.R. 4557 requires Federal bank regulators, before transferring assets of insurance companies to banks, to ask the insurance regulator to determine if the transfer would harm the insurer. This seems like another commonsense clarification to limit a regulatory conflict of interest and to avoid harming insurance policyholders to support a bank.

The proposed Insurance Data Protection Act would provide additional protections for confidential proprietary data shared among insurance companies and government entities and limit rather extraordinary regulatory subpoena power given to nonregulators. This will prevent potentially costly data calls by entities which neither supervise our companies nor are responsible for their solvency.

The theme of all of these bills is that insurance and banking are fundamentally different. Congress has the opportunity to clarify that regulation of insurance companies and their activities should be conducted using insurance standards and by their supervisors.

Thank you for the opportunity to testify today. And I am happy to answer any questions the committee may have.

[The prepared statement of Mr. Kohmann can be found on page 72 of the appendix.]

Chairman NEUGEBAUER. Thank you, Mr. Kohmann.

And finally, Professor Schwarcz, you are recognized for 5 minutes.

STATEMENT OF DANIEL SCHWARCZ, ASSOCIATE PROFESSOR OF LAW, AND SOLLY ROBINS DISTINGUISHED RESEARCH FELLOW, UNIVERSITY OF MINNESOTA LAW SCHOOL

Mr. SCHWARCZ. Thank you very much, Chairman Neugebauer, Ranking Member Capuano, and members of the subcommittee for inviting me to testify.

I am going to spend most of my oral testimony talking about several of the legislative proposals. But before I do that, I think it is important to foreground my remarks in certain facts that I think have gotten lost in this discussion. Those facts include that AIG securities lending program was at the heart of AIG's problems, in addition to its credit default swap portfolio. And that securities lending program, as mentioned earlier by one of the Members, was indeed subject to State regulation. Those facts include the fact that financial guaranty insurers, monoline insurers, contributed mightily to the crisis, and they were regulated by State insurance regulators.

Those facts include that life insurers that had issued long-term guarantys, via annuities mostly, suffered severe capital shortfalls during the crisis that led several of them to apply for bailout funds and to receive bailout funds.

The point I am making is this: I agree with everyone that insurance is different than banking, and it must be regulated in a manner that is different than banking. At the same time, insurance does raise systemic risks that warrant a robust Federal involvement in the industry.

We cannot simply defer to State regulators when issues of systemic stability are in play. With that in mind, I want to talk about several of the proposed legislative initiatives.

First, the Capital Standards Clarification Act. I support the vast majority of that bill. I agree that the Federal Reserve should not mechanistically apply bankcentric capital rules to insurance companies because insurance companies present different risks. And so for that reason, I agree that the Congress should clarify that the Fed has the discretion to tailor capital rules.

Moreover, I think that it is a virtue of the bill that it allows and affords the Fed the discretion not simply to move away from simply mandating bank capital rules but also to tailor capital rules so that they don't simply replicate State risk-based capital rules but actually respond to the fact that while State risk-based capital rules are about policyholder protection, Federal capital rules are by and large about something different: They are about systemic stability. And for that reason, appropriate capital rules for federally-regulated insurance companies may depart in important ways from State risk-based capital rules. The legislation, the bill, as I read it, affords the Feds that discretion.

What I am concerned about, though, is the last provision in the bill that would prohibit, as I understand the language, the Fed from demanding information from regulated insurance companies that is not included in SAP reports.

One thing that we have to take away from the financial crisis is that systemic risk arises in unpredictable ways. And a regulator must have the capacity to adapt to new circumstances, to gather information in a way that allows it to see the full panoply of risks.

There are ways in which SAP may not allow the Fed to do that. The most important and most clearly recognized is that SAP is an entity-centric accounting approach. It is not designed to reflect the risks of an entire conglomerate. It is designed to reflect the risks of individual insurance entities. It is very difficult, if not impossible, to get a sense of an entire insurance holding company simply using SAP. For that reason, it very well may be appropriate for the Fed to require either GAAP reporting or something different than either SAP or GAAP. Maybe something that is referred to as "GAAP-like." Whatever it is, the Fed has to have the discretion if it is going to regulate insurers appropriately to demand the information it needs to adjust to the demands of systemic risk regulation.

I am concerned that the provision in this bill that seeks simply to prevent duplicative accounting will actually be interpreted to limit the Fed's authority to demand relevant and necessary information from the entities that it regulates that is not captured in SAP accounting standards.

I am also concerned about the Data Protection Act. The Data Protection Act may indeed retain the FIOs and OFR subpoena powers. But it has a provision that is virtually unprecedented as far as I am aware. That provision requires either the Treasury or the OFR to reimburse companies to the extent that they have to comply with a subpoena. The reason that we have the FIO and OFR monitoring insurance companies is because they raise certain sys-

temic risks. Because they raise those risks, we need to make sure that those risks don't come to fruition.

The costs associated with that should be borne by the company. If we force FIO and OFR to bear those costs, then we will politicize the subpoena process and will make it very difficult for that process for move forward in a way that is predictable.

Thank you very much.

[The prepared statement of Professor Schwarcz can be found on page 80 of the appendix.]

Chairman NEUGEBAUER. I thank the gentleman.

We will now begin the questioning. Each Member will have 5 minutes.

The Chair recognizes himself for 5 minutes.

Mr. Hughes, in your written testimony you mentioned that this bankcentric standard would harm the ability of life insurers to perform their fundamental business. We have thrown around a lot of terms here, "bankcentric," "capital standards," et cetera. But I think one of the things we sometimes have to do is we have to boil this down to the people that we are really trying to help here and to protect, and that is your policyholders and my constituents.

Talk to me about, if the Fed were to move forward, if we didn't correct this, the young family out there in America, how could this impact them? Because I think that is the real issue here.

Mr. HUGHES. Mr. Chairman, I will give one easy example to maybe address that question. To address the needs of that family, life insurance companies often issue protection products that have promises that will extend 20, 30 years out. We back up those promises of those long-term liabilities with long-term assets. Typically, these are fixed-income securities, generally high-quality corporate bonds.

So in our world of insurance and insurance regulation, our regulators like to see that 30-year promise to the family backed up by a 30-year high-quality bond. And the matching of the asset and liability lowers the risk of the enterprise.

You take the same portfolio security, that same long-term bond in the portfolio of a bank, which has demand deposit obligations, very short-term obligations, and Federal bank regulators say, quite correctly, well, that creates a risk mismatch for the bank. They have short-term obligations. You don't want to back that up with an illiquid long-term bond.

So the Fed would say the capital weight you give that bond, it has a very high capital requirement because it is highly risky in the hands of a bank.

They basically would be forced to do the same thing for an insurance company. And I can't imagine a scenario where the promise we make to that family, that 30-year promise, is backed up by short-term Treasuries. I don't know the risk of not being able to meet a promise of 10, 20, 30 years out would be much higher. So that is an example of the same security in the hands of an insurance company as in the hands of a bank.

And H.R. 4510 would enable the Fed to say, okay, it is a totally different balance sheet. Let's look at assets differently for an insurance company than we would for a bank.

Chairman NEUGEBAUER. And so that additional liquidity and capital would relate to higher premiums for the product that you have been offering?

Mr. HUGHES. Absolutely.

Chairman NEUGEBAUER. In other words, ultimately, the policyholders are going to pay for this mismatch in policy if the Fed were to continue.

Mr. Karol, would you agree with that statement?

Mr. KAROL. I agree with that completely. The liabilities that a bank focuses on are subject to different risks than insurance, particularly property casualty insurance. The bank has credit risk, the bank has inflation risk, the bank has market risk. Where with a property casualty insurance company, it is basically the risk of the damage to the property or the underlying risk. It is basically a completely different business.

Chairman NEUGEBAUER. Mr. Kohmann, do you want to comment on that?

Mr. KOHMANN. No. I would agree with both Mr. Hughes and Mr. Karol. The core issue here is that the businesses are fundamentally different. It would increase costs and potentially create capital that would be addressing asset risk rather than liability risks. So, in my view, it would be no more appropriate to apply risk-based capital rules to a banking entity, which would create potential adverse motives for the wrong risks.

Chairman NEUGEBAUER. Thank you.

Mr. Carter, who would benefit most from the Modernizing the Liability Risk Retention Act as proposed by Mr. Ross? Who are the beneficiaries?

Mr. CARTER. Mr. Chairman, I think that is a great question. And as we think about providing additional services, additional coverages to our members, we think about the smaller to midsized businesses. In our world, it is educational institutions that don't necessarily currently have a staff, don't have a staff for all of the training needs, all of their risk management, and risk management needs.

And so when we think about actually offering property packages, property coverage offerings in our packages, we are thinking about ways to help them manage those risks in an additional—at a higher level than they do today. In a way, that also helps them maintain their budgets, not necessarily have to—we are giving them support, in other words, whether it is White Papers, whether it is online training, whether it is onsite visits, any number of Webinars and seminars. We are giving them a lot of support through the risk retention group model.

And that is not only for United Educators, but also our risk retention group peers. We are only owned by them, and we are delivering more than just insurance to them. So this expansion would be very important to them.

Chairman NEUGEBAUER. I thank the gentleman.

And now the ranking member, Mr. Capuano, is recognized for 5 minutes.

Mr. CAPUANO. Thank you, Mr. Chairman.

And again, I think we have heard many of the items that relatively are noncontroversial. And to be perfectly honest, maybe I

am wrong, but I think that the capital standards issue could be put on a suspension calendar and passed overwhelmingly.

With a question about the GAAP versus SAP, I am not sure how I feel about it yet. I have some questions, but I will come back to it, because I don't know how much time I am going to have. I want to talk about the things that are more concerning in some of the other bills.

And again, all of these bills have things which are easy to support, and some have questions. In particular, in H.R. 605, why—Mr. Karol, I think I am right that you testified in support of that. Why would we have to get rid of the orderly liquidation as a final backup opportunity? It is not the primary backup opportunity, not the primary process, as I understand it. But if everything else fails, why should we get rid of that? What does it hurt to have one final backstop in case, God forbid, we get into a situation where it is necessary? How does it hurt the industry? If I am wrong—I thought you were the one who testified in favor of that.

Mr. KAROL. Our position is that the Orderly Liquidation Authority should not apply, that the State-based system is adequate at this point, and that requiring duplicative payment by insurance companies is not fair, that there is sufficient backup by the State—

Mr. CAPUANO. So it is the up-front payment that you are concerned with?

Mr. KAROL. If the insurance companies are paying into the State authority, which is adequate, our feeling is that if the other banks and other financial institutions aren't paying into that as a backup to them, we shouldn't have to pay into the Orderly Liquidation Authority.

Mr. CAPUANO. Again, I really have to go back to Mr. Schwarcz's comments. I have no problem with the concept of State-based regulation. AIG was regulated at the State level. We keep forgetting that. And I understand full well that the State regulators said that they don't do CDOs, which, of course, is lack of State regulation.

So if that doesn't concern you, if that doesn't kind of ring a red bell, I am happy to look the other ways. Because I am not looking to impose it.

I just look at the orderly liquidation when it comes to insurance companies as something that hopefully, God forbid, we will never need. But I would have a hard time saying, after what we just went through, I don't want to go through that again. And that is what the whole orderly liquidation is all about, is to try to prevent us from ever having to do that again.

And again, if it doesn't work here for insurance companies, I am more than happy to discuss it. But to just throw it out I think is raising a risk that is potentially repetitive. Now, if it is overly burdensome, I am more than happy to talk about it. I would like to have some discussions at a later time, maybe not now, but to walk me through how we can maybe rebalance that. Again, I am not trying to hurt anybody.

Mr. KAROL. I would be happy to talk about it.

Mr. CAPUANO. I guess I also want to talk about the reimbursement aspect. Again, on FIO, limiting their subpoena power, that is fine by me. They have never used a subpoena, to my knowledge,

and I am not looking—I totally agree that they should ask everybody before they get the subpoena.

Why in the world would we want them to—if they have to get to the point where they ever have to use a subpoena, why would we want to force a reimbursement? We don't do it to ourselves. Congress asks every single agency in the world for document upon document upon thousands of documents.

Mr. Neugebauer and I were part of an oversight committee a few years ago. We got reams of documents. We didn't ask for reimbursement. Because asking for reimbursement is de facto a punishment. And in this case, it would for all intents and purposes say, how dare you ask for it? Why do we need a reimbursement aspect if you actually think that at some point FIO would ever need it?

Does anybody support the reimbursement provision?

Mr. KAROL. My understanding of both the OFR and FIO is that they are not enforcement entities; they are basically entities that exist to determine what is going on in the market to predict what is happening—

Mr. CAPUANO. Information gathering. That is correct.

Mr. KAROL. And to get that. The amount of information that is available to them through the States and through the companies is extensive. We really don't know what—

Mr. CAPUANO. Which is why they have never used the subpoena power. They have never had to use it. And the likelihood of them ever using it is minimal.

Mr. KAROL. And everything we can think is that if such a request came through, it would be so extraordinary that, one, it should go through the Secretary of the Treasury—

Mr. CAPUANO. I have no problem with that.

Mr. KAROL. And that if it is that far outside of the normal business of the insurers, it would be fair to have that—that be reimbursed—

Mr. CAPUANO. But all that basically does is if it is so far out there, again, I guess it depends, I would actually think if it is so far out there, maybe there is a real problem that they are not getting answers to; that is the last step before a subpoena.

And, again, I have no problem having the Secretary of the Treasury sign off. But it just says to me, basically, we are not giving it to you, period, end of issue. And if you do, you have to pay us for it. And, by the way, it is going to be an extraordinary amount of money, because these things do cost a lot of money.

Hopefully, just having the subpoena power there is really what gets cooperation. This committee has done it relative to HUD. We have worked out between ourselves, not issuing a subpoena, having HUD come up with certain documents that we worked out in an agreement after some pressure was put on. It just strikes me as a problem.

I guess my last 14 seconds is, with today's world, GAAP and SAP, it really doesn't matter to me. GAAP, SAP, FAAP, BLAAP, it doesn't matter. Pick one accounting standard. I don't care which one. Why would we not want to have one uniform accounting standard so we can compare apples to apples?

Now, I understand the transition from any accounting standard to another one is always problematic. Why would we want to have

2 or 3 or 4 or 10? Why not just one? And it doesn't matter which one to me. Pick one.

Chairman NEUGEBAUER. I thank the gentleman. And now—

Mr. CAPUANO. I will get to that later.

Chairman NEUGEBAUER. I am sure that if you would like—

Mr. CAPUANO. No, no, no. It was a rhetorical question.

Chairman NEUGEBAUER. The Chair now recognizes the vice chairman of the subcommittee, Mr. Luetkemeyer from Missouri.

Mr. LUETKEMEYER. Thank you, Mr. Chairman.

Interesting discussion today. We had a discussion earlier today with regards to systemically important institutions and had the whole discussion about capital requirements, Basel implications, international standards being applied to our companies. It is like, holy cow, this is like subcommittee repeat 2.0 here.

But it is great to be with you, and thank you for your testimony. It reinforces a lot of what we heard this morning.

Mr. Kohmann, I would like to start with you. Your company, as I understand it, not only is an insurance company, but also owns a bank. Is that correct?

Mr. KOHMANN. That is correct.

Mr. LUETKEMEYER. So you understand firsthand the difference between the two, and that the capital requirements for each one are completely different. They are two completely different business entities with two completely different business models. What do you think about the capital requirements of banks being applied to insurance companies?

Mr. KOHMANN. Thanks for the question. As we said earlier, I think they are fundamentally, as you said, different businesses, and accordingly, applying capital standards to them in the same way would be inappropriate and perhaps risky.

Mr. LUETKEMEYER. Okay, how do you define "risky" here? Would these standards affect safety and soundness of the bank and/or the insurance company? How is it going to affect costs to your clients or the insurance clients, the bank clients? Can you give us a little synopsis.

Mr. KOHMANN. Sure. I think, first off, you have the potential by applying an asset-based capital model to insurance companies would not appropriately address the risk of an insurance company, particularly a property casualty company like Westfield, where the majority of the risks are underwriting and reserve risks. So that capital approach could be misguided and put policyholders at risk by not adequately addressing the main risk of an insurance company.

The alternative would be true if you had tried to apply an insurance-centric approach to a bank. We are not talking about that, but trying to think about the other way helps lend clarity to how inappropriate it would be to apply those rules to an insurance company, and I think there is a potential in doing that to certainly add costs to policyholders and consumers in the event that you come up with an inappropriate capital amount and/or more complexity.

Mr. LUETKEMEYER. Mr. Karol, your group deals with lots of different sizes of insurance companies. Would this—how is it going to affect the small ones in your group versus the large ones in your group?

Mr. KAROL. I think these types of standards would affect the smaller companies much more. They have less ability to adjust to the—

Mr. LUETKEMEYER. Would it drive them out of business?

Mr. KAROL. It could.

Mr. LUETKEMEYER. What do you think the potential is for, say, the smallest 25 percent of your companies, how many of them would you think—

Mr. KAROL. We have members who write in a single county. We have members who write in very small areas, and to apply these types of standards or the potential for applying these types of standards to them could put them out of business.

Mr. LUETKEMEYER. They don't have the ability to raise the kind of capital it is going to take to make this all work, is that what you are saying?

Mr. KAROL. Yes.

Mr. LUETKEMEYER. Okay. Mr. Hughes, you deal with life insurance folks. What kind of costs do you think would be pushed on to your clients if some of these standards were implemented? Do you have a different business model, a little bit different business model than P&C guys?

Mr. HUGHES. Yes, it is. For us, it is the cost of capital. If we have to have inordinate capital charges because of the long-term securities we are holding to match long-term liabilities, as the chairman noted, it is going to force companies to pass on those costs to policyholders, which will raise the costs of insurance.

Mr. LUETKEMEYER. How many of your companies went out of business in 2008 as a result, a direct result of the downturn?

Mr. HUGHES. We had two very small companies that went out of business ironically because they had an inordinate amount of their reserves in Fannie Mae preferred, both of them.

Mr. LUETKEMEYER. So it wasn't management of the company, it was investments that they made? Is that right?

Mr. HUGHES. Precisely, yes.

Mr. LUETKEMEYER. Okay. So, out of all that turmoil, you lost two small companies, and now you are being impacted in a very negative way with these cumbersome and overzealous regulations. Thank you for your comments.

I yield back, Mr. Chairman.

Chairman NEUGEBAUER. I thank the gentleman.

Now the gentlewoman from New York, Mrs. McCarthy, is recognized for 5 minutes.

Mrs. MCCARTHY OF NEW YORK. Thank you, Mr. Chairman.

Professor, when you were talking, something hit my mind that when we were writing the bill, so I just want to see, to clarify to see if this satisfies you. When you were making points about SAP and GAAP, and I agree with my ranking member, our bill says an insurance company that is not federally-traded and is already regulated by the State level is not required to prepare a GAAP statement, but that doesn't stop the Fed from asking for additional information because we were concerned about that because I happen to think most insurance companies are good players, but we wanted to make sure that we could keep them to be good players. So

I hope—and if you have any questions we would be more than happy to sit down with you and talk about it.

Mr. SCHWARCZ. Sure. Two quick points: The first one is that it may be necessary for certain insurers in order to arrive at a consolidated sense of how risky the company as a whole is to have GAAP reporting, and that is because SAP reporting is inherently entity-centric. It doesn't allow for the positioning of all assets and liabilities on a single balance sheet in a way that is simple, okay? And so the Fed, I know, right now is investigating how they can take SAP and leverage it to get at a sort of holistic perspective on a group, but from my understanding, this is very difficult, if not impossible.

The second point, though, is I am concerned with the current language that if the Fed, for instance, said, look, we don't need you to go, to give us a full GAAP reporting, but what we do need is lines, is, say, line 5 of a GAAP report on this or whatever it is, we would like you to provide that to us. The company could come back and, under the language as I read it, say, "No, we are not required to provide you anything above and beyond what SAP requires," and so to the extent the information you are seeking is not encompassed within SAP, you are overstepping your bounds, and the way, the reason I see that is because otherwise, it is very hard to understand how you could effectuate this principle, right? Because what if they ask for five items on the GAAP report or 10? At some point, it becomes the full GAAP report. So I think there needs to be clarification about the Fed's capacity to get individual pieces of information, and I also think that there may be circumstances in which it would be, in fact, appropriate to have full GAAP reporting if it is necessary to, if such reporting is necessary, to arrive at a holistic sense of the risk that an insurance group poses.

Mrs. MCCARTHY OF NEW YORK. As I said, we will follow through with that, and certainly, we will talk to Congressman Miller because we have the intentions that there would be a stopgap there to be able to have the Fed ask questions if they felt that there was something reasonable there. But thank you, and we believe that we covered it, but we will take a second look at it.

As far as the others, I know everybody in Congress, or I should say the American people, the majority of us actually do work well together. We sit together. We try to work out things that we know are going to affect us back home in our States and certainly our businesses. So I think this is a perfect opportunity that you can see what we do, and we have worked on this committee bipartisanly. It doesn't always work, but this time around, it truly has.

So, with that, from the testimony that I heard and I appreciate everybody coming in to give their opinions on it, I think all the questions that I would have asked have already been asked, so I am not going to ask them again. The testimony has actually been very excellent, and I think it just shows that we can work together. But I will say, during Dodd-Frank, and I actually like to call it Frank-Dodd, we spent a year and a half working on that bill together, all of us, and we all had questions. Unfortunately, when it went over to the Senate, they had a very short period of time to work on it and didn't look at the consequences on some of the language that they put in there. I will say that Barney Frank took one

section, and even when we went to the second section, we went back to the first section to see if we were countering each other, but as this place has never passed a perfect bill, it will never pass a perfect bill, but that doesn't mean we can't make technical changes, and that is what we are doing today.

With that, I yield back the balance of my time, sir.

Mr. LUETKEMEYER [presiding]. Thank you.

With that, we go to the gentleman from Wisconsin, Mr. Duffy, for 5 minutes.

Mr. DUFFY. Thank you, Mr. Chairman. Whether Dodd-Frank or Frank-Dodd or sometimes we call it by other names as well, but we won't say that here, I do appreciate the bipartisanship that has gone on in regard to some of the bills that were proposed today.

Maybe the panel could help me a little bit with some history. Is it fair to say that we have a pretty long and deep history of banking in America and some crises that come from the banking sector? Does banking sometimes create risk throughout our history for the larger economy? Anybody? You guys all agree with that, right? I am not crazy? Banking creates risk? Isn't that kind of why we all come together and we get really freaked out in banking crises?

And what also freaks us out is when the taxpayer bails out banks. We don't like that. We want banks to have sound capital standards so those investors in banks will bear the risk and the loss and not the taxpayer, and I think a lot of us feel the same way about the insurance sector.

Do we have the same kind of history in the insurance sector with creating systemic risk similar to that of the banking sector? Mr. Carter, do you know? Mr. Hughes? Anyone? You can jump in, chime in.

Mr. CARTER. I don't personally believe so. I think that the business models, as we have heard before, are very different, and the way they run their businesses are very different, and I think if you look at the history of failures, of institutional failures, I think there is a difference. I don't know the exact numbers, but that would be my statement on it.

Mr. DUFFY. Maybe I will throw it out a different way, if you look at it from the Great Depression to the Great Recession, oftentimes we have had banks that have caused some of these crises and runs on banks. Is there another historical example that you can give me where a crisis in America has been caused by the insurance sector?

Mr. SCHWARCZ. Yes. Let's not forget about 2008, right? This is a pretty important salient example, and again, I think it is really important to remember that the AIG securities lending program, monoline financial guaranty insurers, life insurers, all of those involved State insurance regulation and involved crises.

Mr. DUFFY. And we will get to that.

Mr. SCHWARCZ. Okay.

Mr. DUFFY. Besides AIG, any other example you can give me?

Mr. SCHWARCZ. Yes. There has been historical precedence of a run on a life insurer; on Executive Life, there was a run.

Mr. DUFFY. But systemic risk—

Mr. SCHWARCZ. It depends on—

Mr. DUFFY. —by insurance companies.

Mr. SCHWARCZ. Right, I would say that it depends—the other example, ironically enough, would be the 1980s liability crisis. The Risk Retention Act was initially passed because there was a crisis of lack of availability of liability insurance.

Mr. DUFFY. Was that systemic risk however?

Mr. SCHWARCZ. It depends how you define systemic risk. It was significant enough that it was on the front page of magazines, and Congress acted to pass—

Mr. DUFFY. But it wasn't going to take down the whole economy like what the theory was in 2008 or the Great Depression?

Mr. SCHWARCZ. I think that is right; it was different.

Mr. DUFFY. Besides Mr. Schwarcz, because I have heard many argue that as you look at the crisis of 2008 and you look at AIG's role, many will say it was the financial products division that was regulated by the OTS that caused the risk in AIG, and it wasn't the traditional insurance arm that was regulated by the State that really caused the risk in AIG. Do you guys agree with that assessment, outside of Mr. Schwarcz?

I know what your opinion is on this one.

Mr. HUGHES. I think I would strongly disagree with Mr. Schwarcz's analysis. I don't think you can point to AIG and say, that equals the whole insurance industry. It doesn't. I think all financial intermediaries discovered during the crisis that their risk modeling probably didn't go far enough out, and that worst case was a whole lot worse than they had anticipated. But if you look at the way the insurance industry came through the crisis, both the life segment and the property casualty segment, I think, without question, we came through that crisis in better shape than any other segment of financial services.

So, yes, AIG was a problem. Yes, there were companies that were under severe stress. But the entire financial system, not only in the United States but globally, was under severe stress, and I think the industry acquitted itself quite well in the crisis.

Mr. DUFFY. As we look at FSOC, they are there to identify risk to financial stability, and we just recently had Prudential that was designated as an SIFI. What concerns me, though, is how the vote on making Prudential a SIFI, you have the OCC, the FDIC, credit unions, the Fed, Treasury, and the CFPB—which has its own problems—all voting to designate an insurance company as an SIFI, but you have the President's designee who was approved by the Senate voting "no" as well as Mr. DeMarco from the FHFA. And I think as I finish off here, the quote is pretty powerful from Mr. Woodall, who said, "The underlying analysis utilizes scenarios that are antithetical to a fundamental and seasoned understanding of the business of insurance, the insurance regulatory environment, and the State insurance company resolution and guaranty funds system." You have bankers and credit unions designating Prudential as an SIFI, and those who know insurance best are voting "no," and saying these other guys don't understand it. I think that is pretty powerful as we analyze how FSOC is looking at insurance.

I yield back the time I do not have, Mr. Chairman.

Chairman NEUGEBAUER. I thank the gentleman.

And now the gentlewoman from Ohio, Mrs. Beatty, is recognized for 5 minutes.

Mrs. BEATTY. Thank you, Mr. Chairman, and Mr. Ranking Member, and like my colleague from New York, many of my questions have already been asked, but I would like to pick up where Ranking Member Capuano left off. It seems like, as we have been working through Section 171, we have come to a pretty good technical fix to this, but it seems like there were still some discrepancies in which accounting standards should be used, and I think that is where Mr. Capuano was going, and it looked like Mr. Kohmann and Mr. Hughes and Mr. Carter were getting ready to jump in there.

So let me pose the question to any one of you in this fashion: Would you explain how the application of, let's say, statutory accounting principles versus general accepted accounting principles could result in a different compliance expectation?

Mr. HUGHES. I think this is one of the more intriguing questions with this legislation, and I read Mr. Schwarcz's testimony, and it caused me to go back and read your legislation and what it actually says. There isn't any question that GAAP accounting and statutory accounting have fundamentally different purposes. GAAP is overseen by the SEC. It is intended to ensure fairness in the marketplace, maybe protection of investors. Statutory accounting, as Mr. Schwarcz noted, is really to protect, to make sure that the solvency of the company is sufficient to protect the policyholders.

Now, whether the Federal Reserve Board at the end of the day, given the latitude that your bill would give them, would just say, fine, we are happy with statutory accounting, I am not sure that they would. We had begun a discussion with the Fed early on to say, it is not that hard to come up with some mechanical analogue to consolidated GAAP financials, it is not audited GAAP, but if you need certain information, it is not that hard to come up with some sort of analogue that would give you what you want.

Now, those discussions stopped because the Fed said that under Section 171, we can't get there anyway. Even if you gave us that information, we couldn't rely on it. So your legislation would do two things: one, it would enable to us restart that conversation with the Fed; and two, if we did come up with a workable analogue, cost-effective, not audited GAAP for a mutual, it would enable the Fed to rely on that as they comply with their statutory mandate. So as we read your legislation the way it reads now, we think it adequately addresses the accounting issue.

Mr. KAROL. There is no reluctance whatsoever to provide the information. I think the question is to require insurance companies who use statutory accounting, which is a more conservative system, based on the interests of the solvency of the company, to have them adopt an entirely different set of reporting standards that are based, again, as they said, for shareholder or investor reasons, under the Financial Accounting Standards Board would impose a burden upon our members for a purpose that may or may not be important to the Fed.

Mr. SCHWARCZ. The concern I have is that if the solution is that we need something in between SAP and GAAP accounting, okay? We need you to use GAAP accounting in this respect or SAP accounting in this respect. We need SAP accounting plus.

The language, as I read it, is quite ambiguous with respect to the question of whether or not the Fed could demand it, and I think just on the technically statutory interpretation as an attorney, one could make a very good argument, if one were so inclined, that the companies are not required to provide anything in addition to SAP or, alternatively, anything in addition to SAP that could be construed as being required by GAAP. And the key point I want to make is the Fed as the regulator of these entities needs the flexibility to be able to see these entities on a holistic basis and to prescribe accounting standards that facilitate that.

Mrs. BEATTY. Mr. Kohmann?

Mr. KOHMANN. I would just add and agree with Ranking Member Capuano that if we could get to one standard, wonderful, but we are not going to do away with statutory accounting for insurance purposes, and I think, with all due respect, Professor Schwarcz, the Fed in their examination process and otherwise I think certainly has the ability to request any and all information that they want, and I think most companies would do their best to accommodate those requests.

I think at the heart of the SAP versus GAAP is the systematic reporting required to the Fed through their reporting system. There is really no way to only provide one set of financial data. So I think the requests that you are talking about that are more from an examination perspective certainly would be accommodated. I think it is a systematic approach to accounting that is troublesome because it does create significant additional cost and complexity to do that reporting, which certainly adds costs to policyholders and depositors.

Mrs. BEATTY. Thank you.

Mr. SCHWARCZ. Could I just add one thing? I don't want to overstep my bounds. I just want to respond quickly.

Mrs. BEATTY. Okay. I didn't know if—

Mr. SCHWARCZ. Quickly, okay. To be clear, what I am talking about is that the Fed might decide, "We systematically, every quarter, want you to report to us items that are not required by SAP because we want to take those into account, say, in your capital standards. So, every quarter, we want you to report to us X, Y, Z that are not covered by SAP because we think they are important in terms of us monitoring you on a persistent basis, in terms of us coming up with capital standards." That is what I am talking about, and it seems to me that the statutory language would not permit that.

Chairman NEUGEBAUER. I thank the gentlewoman.

Now the gentleman, Mr. Stivers, is recognized for 5 minutes.

Mr. STIVERS. Thank you, Mr. Chairman. I appreciate you recognizing me, and I appreciate you holding this hearing on these important bills.

Before I start, I typically have an aversion to opening statements, so I don't request to do them, but I do want to make sure everybody in the room understands the unique background of my fellow Buckeye, Mr. Kohmann, who not only is a CPA, he was a CPA at Ernst & Young, and he has been a CFO for a bank and for an insurance company, so he is in a unique position with regard to the capital standards clarification bill that we have talked about

recently through the gentlelady from Ohio as well as Mr. Capuano from Massachusetts and others on the committee. I think almost everyone has talked about that bill.

But, Mr. Kohmann, from your position, having been a CFO at a bank and understanding how banks work and now being at a property and casualty company, can you tell me, do you think a bank and an insurance company are exactly the same and the same exact capital standards would work for the two different business models?

Mr. KOHMANN. Thank you, Congressman.

No, absolutely, as I stated before, they are different. But I would add that having been a CFO for both entities, both I and Westfield would be supportive of strong capital standards for both types of institutions, so I believe that strong and prudent capital standards for banks are necessary and as well as strong and prudent and appropriate capital standards for insurance companies. The problem herein lies that one or the other is not appropriate for both so we need unique capital standards.

Mr. STIVERS. Is there anybody on the panel who believes that the McCarran-Ferguson model for regulating insurance is not working?

I would note that no one shook their head "no."

The State-based standards for capital work very well, and I know that the gentleman from Wisconsin talked earlier about the fact that State-based regulated entities had no problem through the entire financial crisis. And the capital standards that the States are imposing under the McCarran-Ferguson law, which has been working for 70 years, is still working and working very well.

You talked a little bit through the gentlelady from Ohio's questions about the issues with statutory accounting versus GAAP accounting. Is there anything, Mr. Kohmann, that didn't come out in that discussion that would cause additional expense to insurance companies, whether they be mutual insurance companies or nonmutuals?

Mr. KOHMANN. No, I think what came out of the dialogue was appropriate. I think there is no question that the requirement to provide GAAP statements in addition to statutory statements would be an additional burden, which would basically create expense and complexity, which ultimately would cost policyholders more in premiums.

Mr. STIVERS. Has your company put a price on what that would cost your policyholders?

Mr. KOHMANN. We have not specifically, no.

Mr. STIVERS. Can you tell me, would it be in the thousands or the millions of dollars for a company the size of Westfield?

Mr. KOHMANN. It would be more than a million.

Mr. STIVERS. So, for medium to large insurance companies, you are talking about six-, seven-, eight-digit costs, tens of millions potentially in some companies?

Mr. KOHMANN. I can't speak for other companies specifically, but that would be my suspicion, yes.

Mr. STIVERS. Thank you. I appreciate that.

The other bill I want to talk a little bit about is the Data Protection Act that I have a discussion draft out on. It is a bill that has changed from a bill we did last year, and I know there has been

some discussion in the committee by the ranking member of the fact that Congress doesn't reimburse, but Congress is usually subpoenaing other government agencies, so it is government agency to government agency, but in Title 18 of the U.S. Code, Section 2706 there is a similar provision to what we are talking about that deals with law enforcement, and when they subpoena commercial or other folks and they reimburse the cost, and I know that Mr. Schwarcz, I am not sure if you said it was unprecedented, but I wanted to make sure you knew the precedent of Title 18, Section 2706. Are you familiar with that section?

Mr. SCHWARCZ. Yes. My understanding is that there is not another precedent for a monitoring agency or an agency that is meant to assess risk to a marketplace having to pay for that, and I would also say that even in the context of subpoenaing—

Mr. STIVERS. I am running out of time, but those are regulatory agencies, and that is why, and so the State-based regulators regulate, we already talked about that, under McCarran-Ferguson, regulate insurance companies, but this is additional, this is much more akin to the law enforcement model because these are not regulators.

So thank you for the time, Mr. Chairman. I know I am out of time. I appreciate the witnesses' cooperation, and thanks for being here. I appreciate your information.

Chairman NEUGEBAUER. I thank the gentleman.

Now the gentleman from Florida, Mr. Ross, is recognized for 5 minutes.

Mr. ROSS. Thank you, Mr. Chairman.

Professor Schwarcz hinted earlier about a 1986 crisis in insurance that I think led to what resulted in the liability risk retention amendments that I think have done very well. In fact, Mr. Carter, if it were not for the risk retention groups, what would your members avail themselves of in terms of a market for liability coverage and, in this particular case, in my draft, property insurance coverage?

Mr. CARTER. Thank you for the question. I think during the times of a crisis, when most of the traditional insurance markets do not feel that they can continue to offer the coverage, it is very, very difficult for the businesses to find the coverages that they are going to need, whatever that be.

Mr. ROSS. You have a unique risk, too, don't you? Your members have a unique risk that you don't find in a commercial line's product. Would that not be the case?

Mr. CARTER. I think, to the extent that there is liability, obviously there is liability inside of our industries as well as others. However, you are correct that the industries, the specific industries that turn to risk retention groups and tended to gravitate to them, nonprofits, educational institutions, many of those were difficult to cover for those traditional insurance markets. So we were formed during that time, and what makes the model really work is during very difficult times, over the course of the years since that time, there has been at least one event that has changed the market, created a market cycle, I should say. Risk retention groups tend to grow quite a bit because of our commitment to those members, so we are not looking to grow outside or we can't grow outside of that.

Mr. ROSS. Correct. You can't offer your product to somebody else outside your membership?

Mr. CARTER. We cannot offer it; that is correct.

Mr. ROSS. You are not in the business of being an insurance company. You are in the business of providing a particular service, in most cases a nonprofit or charitable service for which you have a unique risk. Now, if you didn't have the risk retention groups, is there a residual market for coverage?

Mr. CARTER. Not that I know of.

Mr. ROSS. And if there was such a market, wouldn't it have to be most likely provided by a government?

Mr. CARTER. That is correct.

Mr. ROSS. Such as an assigned risk pool?

Mr. CARTER. That is correct.

Mr. ROSS. Such as what we saw in Florida and what we have seen in other States? So if we don't have affordable coverage for your members, then they can't provide their service, and if they can't provide their service, which is a nonprofit charitable service, then: one, where does the client go, and two, who insures that risk? Just because the services aren't being provided by your organization doesn't mean the risk for those services is not going to still be out there because somebody, most likely a government, will provide those services.

Mr. CARTER. That is correct.

Mr. ROSS. Now, with regard to capital standards, and I just want to ask Professor Schwarcz this particular question. I understand, I just want to make sure, you are not suggesting that FIO now have regulatory authority, are you?

Mr. SCHWARCZ. No.

Mr. ROSS. Okay. And when you consider the cost of compliance as well as the cost of increased capital having to be held, would that not play into any cost-benefit analysis as to whether a regulation should be implemented or not?

Mr. SCHWARCZ. Yes.

Mr. ROSS. And in this particular case, if we are not clear on the Collins Amendment and that we don't have bankcentric capital standards apply to insurance companies, we may very well have a situation where the cost of compliance may outweigh the affordability of the product?

Mr. SCHWARCZ. Yes, I am in agreement that the language making it clear that the Fed has discretion to tailor capital rules to insurers is a good idea, and I agree that the risk, the cost-benefit analysis is relatively clear on that.

Mr. ROSS. And I would assume as well, Mr. Kohmann and Mr. Karol?

Mr. KAROL. Yes.

Mr. HUGHES. Yes.

Mr. ROSS. I yield back.

Chairman NEUGEBAUER. I thank the gentleman.

And now the gentleman from New Jersey, Mr. Garrett, is recognized for 5 minutes.

Mr. GARRETT. Great. So, I thank the panel again.

Going back, I will start from the right. Professor Schwarcz, you made the comment—and I want to see where you are going on

this—before that there were a number of insurance companies who had problems and failed regulations, and you referenced AIG and a couple of other ones, and for that reason, we should have, in your words, turned some of this over to Federal regulation in this area. I am paraphrasing.

Mr. SCHWARCZ. Yes. The basic argument is that we saw that insurance can be systemically risky in more limited circumstances than banks.

Mr. GARRETT. Right.

Mr. SCHWARCZ. For that reason, we need a Federal layer of oversight and protection.

Mr. GARRETT. Protection, right.

Mr. Hughes, I think somebody asked you about how many carriers, insurance companies failed, and I think you alluded to only a handful, and that a couple of them actually failed not because of their own doing but because of Federal regulation because they were encouraged to buy trusts secured in Fannie Mae and Freddie Mac. So this is where I am sort of confused, Professor.

If you look at the numbers, the number of insurance companies that failed is on one and a half hands, it is AIG and a couple of other ones, and actually, weren't the two major companies that failed actually also regulated by the Federal Government at the same time?

Mr. SCHWARCZ. So, to be clear, there were several insurance companies that received TARP bailout funds.

Mr. GARRETT. Right.

Mr. SCHWARCZ. Many more than applied, okay? So, there were many. And there were many insurers that contributed to the crisis without necessarily failing. One important point to recognize—

Mr. GARRETT. The important point is that, by and large, they didn't fail or they didn't actually have to get government backstop or support except for a couple.

Mr. SCHWARCZ. Several—

Mr. GARRETT. And the ones that did get the support actually were regulated. AIG, which was probably bailed out the most of all of them—the Office of Thrift Supervision, they were supposed to be doing it. The other one at the very top that got it was a bank holding company, and who would that—wasn't Hartford a bank holding—

Mr. SCHWARCZ. Hartford was a recipient.

Mr. GARRETT. Not a bank holding company?

Mr. SCHWARCZ. I do not believe it was.

Mr. GARRETT. So AIG would have been the top; they were government-supervised. So it seems as though the ones that got the most money also had a Federal regulator that failed, and if you look at most businesses or financial institutions that failed, they would be on the other side of the ledger. They would not be insurance companies. They would be the banks, and weren't the banks regulated by the Fed?

Mr. SCHWARCZ. It is funny, we all keep talking about the banks, a lot of the crisis was caused by an unprecedented expansion of shadow banking. So the point is this—

Mr. GARRETT. I know, the point—

Mr. SCHWARCZ. That was new. And the point is you can't just say, oh, well, banks are the problem so banks are going to be the problem in the future. Systemic risk arises in new ways.

Mr. GARRETT. Right, and that is why we need to have regulators to do the job, but apparently—

Mr. SCHWARCZ. Right, monitors and regulators who have the powers to do the job.

Mr. GARRETT. But the regulators didn't do their job. We had Secretary Geithner here back in 2009, and he was answering a question—I was just seeing this from earlier—and he said that in 2009, after he had just left the New York Fed, that, in his words, "I just want to correct one thing, I have never been a regulator for better or worse." So here is a guy, one of the regulators that we are supposed to be turning all this control over to, being paid $400,000 a year, being in the job of heading the New York Fed testifying to Congress that, "I am not a regulator." Is this exactly where we should be in turning over the authority to when, as Mr. Hughes and others on the panel have testified to, we don't really see the problem on the State level? We see the failed regulation at the Fed, at the New York Fed, at the Office of Thrift Supervision, and on other issues outside of the realm of this panel, such as the SEC, with other areas as well. It seems as though it is endemic as the problem is where the Federal regulators have gotten involved and failed to do their job with the authority that they had at the time, and as a matter of fact, we go all the way back, we asked the regulators when they came in right after the crisis of 2008, did you need additional authority or power at the time, and they said, "No, we just didn't see what was happening here."

And what we are trying—so to go forward, your suggestion is we just need to give the regulators even more authority and more information, but would you agree that there is some limit that we should impose on the information that they should be able to acquire?

Mr. SCHWARCZ. Of course. I think that the information should be—whether or not they request information should be based on a prudent judgment of the need, but I would also—the point.

Mr. GARRETT. Correct me if I am wrong, Dodd-Frank gives the FIO subpoena authority, correct?

Mr. SCHWARCZ. It only allows them to use that subpoena authority if they have made a determination that they cannot receive the information from any other source, State or Federal.

Mr. GARRETT. Right. But isn't that unusual? Can we cite any other case where you have subpoena authority where it is not a criminal or an administrative position?

Mr. SCHWARCZ. One of the things Dodd-Frank did to address the fact that systemic risk is always changing is create institutions like OFR and like FIO that are meant to try to anticipate these. Are they going to work all the time? Of course not. But the answer is—

Mr. GARRETT. But is there any other institution that has that authority right now and is not in a criminal or administrative position?

Mr. SCHWARCZ. I think they are a unique organization, but I think on the scale of regulation versus crime enforcement, they are a whole lot closer to regulation than crime enforcement, and they

are doing a job that is monitoring systemic risk which is in a sense much closer.

Mr. GARRETT. I yield back. Thank you.

Chairman NEUGEBAUER. I thank the gentleman.

And now the gentleman from California, Mr. Sherman, is recognized for 5 minutes.

Mr. SHERMAN. I thank the chairman. I notice in talking about the risk retention draft, there is a noted absence of necessary speed with which to take this up, I assume because there may not be a push from the groups really pushing that effort forward. I wonder who would want to comment about the speed of dealing with the risk retention draft?

Mr. CARTER. That would be my area, but I am not quite sure I understand the question. Would you mind repeating it? I didn't hear the first part.

Mr. SHERMAN. You know what? I think I am going to go on. Who can comment on why we wouldn't regulate credit default swaps as an insurance product?

Mr. Hughes?

Mr. HUGHES. Personal opinion, it is a form of financial guaranty insurance. I think it probably should have been in a monoline company and not part of a multiline company.

Mr. SHERMAN. You are saying it should be part of a monoline company, but a regulated insurance company?

Mr. HUGHES. That would be my personal opinion, yes.

Mr. SHERMAN. If I had decided that I wanted to be in the fire protection business, but my deal was this, if your house burns down, I don't write you a check; that would make me an insurance company. Instead, if your house burns down, you can trade your house for a U.S. Government bond, would I be a fire insurance company, or could I evade all fire insurance company regulation?

Mr. SCHWARCZ. You would be an insurance company.

Mr. SHERMAN. What?

Mr. SCHWARCZ. You would be an insurance company.

Mr. SHERMAN. I would be an insurance company if I did a burned home for credit for a bond swap, but if, instead, of your home burns down you can trade it for a U.S. Government bond, that would make me an insurance company, but if your portfolio burns down, you can trade it for a U.S. Government bond, I am not an insurance company, or at least I am not defined as one under U.S. law?

Mr. SCHWARCZ. That is exactly, yes, the boundaries and the fact that we have regulatory arbitrage and we have insurance companies engaging in many of the types of activities that banks and shadow banks engage in is exactly why we can't ignore the systemic risk of insurance companies, we can't simply say, the States are doing a fine job, so we are going to leave them alone.

Mr. SHERMAN. Wait a minute. That credit default swap that I just described is not, cannot be done by a regulated insurance company, correct?

Mr. SCHWARCZ. Correct, but monoline insurers, financial guaranty insurers did the exact same thing, and they failed miserably as well. State regulated insurance companies issuing financial guaranty insurers, they failed just as dramatically.

Mr. SHERMAN. They failed to the point where they had to be bailed out?

Mr. SCHWARCZ. They didn't—they failed to the point of insolvency, to the point of contributing mightily to the crisis, yes, because what happened is, all of a sudden, the financial guaranty insurers were providing—their classic business was to provide insurance against the default of local bonds and State bonds. When they failed and became insolvent to the point that no one had any faith in them, the entire bond market seized up because there was no financial guaranty—

Mr. SHERMAN. But we in Congress didn't have to bail them out?

Mr. SCHWARCZ. I don't believe that any of them received bailout funds.

Mr. SHERMAN. Okay. Has anybody put forth an argument against the Policyholder Protection Act simply making it clear that you can't raid the insurance company to support the depository institution? We have a whole panel here. Somebody raise your hand if you have an argument against the bill. Wow, passed it unanimously. Thank you.

Okay. I am going to amaze my colleagues and yield back 46 seconds.

Chairman NEUGEBAUER. I thank the gentleman.

And now the gentleman from Florida, Mr. Posey, who has a couple of bills that we have been considering today, is recognized for 5 minutes.

Mr. POSEY. Thank you, Mr. Chairman, and thank you for today's hearing on legislation that is very important to the insurance industry, and for allowing me the opportunity to speak today.

A question for Mr. Kohmann: Dodd-Frank requires insurance companies can be made to serve as a source of strength for affiliated depository institutions. State insurance regulators wall off assets of insurers from other affiliated companies because insurance assets are supposed to be available to ensure an insurer can meet its obligations to policyholders. But if an insurer is expected to serve as a source of strength to noninsurance firms, couldn't that harm the insurer's policyholders? Why would we favor protecting consumers, banks, and other risky financial firms over protecting innocent insurance policyholders? They are the most innocent potential possible victims. It seems like we want to focus—Mr. Schwarcz wants to focus on protecting the investors of these institutions that can't keep themselves in business rather than worry about the victims when they are forced to go out of business. I would just like your thoughts.

Mr. KOHMANN. I think the answer to your question is we shouldn't jeopardize the policyholders of an insurance company that is State-regulated in order to use those assets to divert those to support banks in a bailout.

Mr. POSEY. And I realize health insurance is different. Every insurance is unique, but they all have something in common, and that is people buy insurance to reduce risk.

Mr. KOHMANN. Right.

Mr. POSEY. They don't buy insurance to increase risk, and if you start stealing from Peter to pay Paul, what you may have is instead of one guy going out of business, you get two, and I don't

know how that is better for anybody, but my experience with Federal regulators in the insurance business—I don't know, Mr. Schwarcz, if you have ever heard of TRG, but it is a health insurance company that wrote insurance policies in 48 States, darn near every State but their own, which was in Indiana. Everything was fine except they didn't pay any claims, and they bluffed most of the State insurance commissioners into thinking they couldn't go after them because they were under the Federal ERISA program.

Mr. SCHWARCZ. To be clear, I support, I also support—

Mr. POSEY. And finally, one State said, if the Federal Government is not going to do anything, maybe we will, and 13 State agencies from different States cooperated to bust those dirtbags and put the principals in prison. To this day, the Federal regulators have done absolutely nothing. They have brought no charges. They are just paralyzed with inactivity. So when I hear somebody kind of insinuating that State regulators are bad and Federal regulators are good, my experience has been just the opposite, and while we all believe, I think, probably, most of the people here have come up through various levels of government, and they know that the government closest to the people is usually the best, the most responsive, the most efficient, the most effective, the most cost-effective, and certainly the most accessible, and I think that goes for regulators, too. I think that goes for law enforcement, too. I think all services that are regulated more closely now. I see nothing wrong with cooperation from the Federal Government, unlike what they did in the TRG case, to facilitate enforcement across State lines, but I think the State regulators are, fortunately for most consumers, the best line of defense against innocent victims.

Mr. Chairman, I want to thank you again for bringing these up. They are very important issues. I yield back.

Chairman NEUGEBAUER. If there are no other Members seeking recognition, I would like to thank each of our witnesses again for their testimony today. Without objection, I would like to submit the following statements for the record: the Independent Insurance Agents and Brokers of America; the American Insurance Association; the Financial Services Roundtable; the National Association of Insurance Commissioners; and a letter from over 50 CEOs regarding the Miller-McCarthy bill.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

This hearing is adjourned.

[Whereupon, at 3:52 p.m., the hearing was adjourned.]

A P P E N D I X

May 20, 2014

United Educators

Testimony of Joe E. Carter

Vice President
United Educators Insurance, a Reciprocal Risk Retention Group
Chevy Chase, MD

The Subcommittee on Housing and Insurance
The Committee on Financial Services
United States House of Representatives

Hearing:
"Legislative Proposals to Reform Domestic Insurance Policy"

May 20, 2014

Mr. Chairman, Ranking Member Capuano, and Members of the Subcommittee:

Thank you for the opportunity to testify as part of the Subcommittee's Hearing on "Legislative Proposals to Reform Domestic Insurance Policy" in favor of the Risk Retention Modernization Act of 2014, which would permit established risk retention groups (RRGs) to offer additional forms of commercial insurance coverage to their members (other than group health, life, or disability insurance or workers compensation insurance). I am a Vice President of United Educators Insurance, a Reciprocal Risk Retention Group (United Educators) and am testifying on behalf of United Educators as well as The Alliance of Nonprofits for Insurance, Risk Retention Group (ANI) and The National Catholic Risk Retention Group, Inc. (National Catholic).

I am happy to report that the legislation also is supported by The Vermont Captive Insurance Association (VCIA) and the Risk and Insurance Management Society (RIMS). The VCIA is composed of nearly 500 member companies and is the largest captive insurance trade association in the world. RIMS, a not-for-profit organization, is the largest organization of risk management professionals in the world, representing over 11,000 members from more than 3,500 entities. RIMS membership includes the commercial buyers of insurance, and represents public and private entities, both large and small, from a variety of industries such as high-tech, real estate, financial, healthcare, energy, transportation, education, and defense.

We are pleased that the leading trade associations representing property casualty insurance companies, captive insurers, and risk management professionals see the wisdom in the modernization of the 1986 Liability Risk Retention Act (LRRA).

My written statement provides a brief description of the missions of the three risk retention groups (RRGs) I'm representing, reviews the Congressional intent behind the 1986 LRRA, discusses the successes of the LRRA, and explains how modernization of the LRRA to include other forms of commercial insurance such as property, auto physical damage, business interruption, and cyber risk insurance will:

- Increase capacity, choice, and market competition for lines of commercial insurance coverage, such as property, auto physical damage, business interruption, and cyber risk;
- Create efficiencies for members of RRGs who will no longer be forced to seek coverage elsewhere for commercial lines that RRGs cannot offer;
- Enable independent brokers and agents to gain efficiencies by offering package policies for all property and casualty exposures to churches, nonprofits, schools and universities and other organizations that typically buy package policies that don't include tailored risk management programs;
- Facilitate improved coverage and risk management for other lines of commercial insurance for the churches, educational institutions, nonprofits, medical groups, and others who purchase insurance through RRGs;
- Lower the overall cost of risk to RRGs and their members; and

- Enable RRGs to provide stable coverage and pricing for other lines of commercial insurance and insulate these lines from the cyclical nature of the larger commercial insurance market.

A. About United Educators, ANI, and National Catholic

United Educators, ANI, and National Catholic all owe their existence to the LRRA of 1986. The worst hard market in the history of American insurance began in 1984 and persisted through most of 1987. The property and casualty insurance market was so bad that *Time* magazine's cover on March 24, 1986 read: "Sorry America, Your Insurance Has Been Cancelled."

In response to skyrocketing insurance rates and, in some instances, a complete inability to obtain coverage, United Educators was created in 1987 by educational institutions for educational institutions with the sole purpose of providing a stable, high-quality, specialized alternative to commercial insurance. Today, United Educators is owned and governed by its 1,200 member schools, colleges, and universities throughout the United States, including Abilene Christian University, Saint Louis University, the Claremont University Consortium, Harvard University, St. Francis College, Rockhurst University, Davis and Elkins College, Fairleigh Dickinson University, University of Missouri, Emory University, Hofstra University, University of Minnesota, Pepperdine University, Ferrum College, Medical College of Wisconsin, Columbus State Community College, Central State University, Lakeland Community College, University of Nevada-Las Vegas, Dallas County Community College, Westmont College, and the University of Alabama System.

United Educators' 27-year history and solid financial track record demonstrate successful execution of the LRRA concept. The selection of United Educators as a 2013 Ward 50 top performing insurance company (making it one of the top 2% of property and casualty insurance companies in the nation) and its A.M. Best rating of A (Excellent) provides external validation of United Educators' financial strength, strong governance, and expert staff. Its consistent retention rate of at least 96 percent - the highest in the industry - confirms United Educators' strength and value to its member insureds.

ANI is part of the Nonprofits Insurance Alliance Group which currently insures more than 13,500 nonprofit organizations nationwide. ANI is a 501(c)(3) tax-exempt nonprofit insurance company governed by its 501(c)(3) federally tax-exempt nonprofits, including animal shelters, volunteer centers, group homes, art programs, library associations, foster family agencies, Meals on Wheels, United Way, Goodwill, Boys and Girls Clubs, and charter schools. Member insureds of ANI include community-based nonprofit organizations such as Southeast Missouri Food Bank, Community-Based Care of Brevard County, Evergreen Center for the Arts, Goodwill of Delaware and Delaware County, Companion Animal Advocates, United Cerebral Palsy of Arkansas, AIDS Foundation of Chicago, Education Alternatives, Pennsylvania CASA Association, Domestic Abuse Services, National Alliance for the Mentally Ill, Jewish Community Center of Northern Virginia, Big Brothers Big Sisters of Puget Sound, Animal Care & Control of New York City, Sunnyside Home Care Project, and Riverton Community Housing. It has grown from initial capital grants of $10 million from the David & Lucile Packard Foundation and the Bill & Melinda Gates Foundation to an insurance company rated A (Excellent) by A.M. Best, insuring more than 5,000 nonprofits in 30 states and the District of Columbia.

National Catholic was incorporated in 1987 as a stock insurance company, with eligible shareholders comprised of Catholic archdioceses, dioceses, religious institutions, Catholic risk pooling trusts, and Catholic entities listed or eligible for listing in The Official Catholic Directory published by P.J. Kenedy & Sons. National Catholic is a 501(c)(3) nonprofit tax-exempt organization and its members include parishes, grade schools and high schools, colleges and universities, cemeteries, and Catholic charities services.

National Catholic consistently has provided the Catholic Church with one of the broadest, most comprehensive insurance and risk management programs available nationwide. In all of its endeavors, it is guided by the commitment to its fiduciary duty as a steward of the assets of the Catholic Church. With a renewal rate in excess of 99%, National Catholic has only lost one member since its inception.

As risk retention groups, United Educators, ANI, and National Catholic share an identical mission: to provide their members with a long-term, stable alternative to the cyclical unavailability and erratic pricing of commercial insurance. Our only business is to meet the risk management and insurance needs of our own industries. Since inception, each of our risk retention groups consistently has provided stable and affordable insurance, responsive to our insureds' unique needs, through all market conditions.

B. The Goals of the Risk Retention Act Amendments of 1986

During the mid-1980s, the United States was shaken by a crisis in the availability and affordability of commercial liability insurance. This crisis did not discriminate between commercial entities, on the one hand, and churches, charities, and educational institutions on the other. Among the entities particularly hard hit were nonprofits, universities, municipalities, child care centers, health care providers, and small businesses. These entities faced huge rate increases, mass cancellations of coverage, and the unavailability, at any price, of entire lines of insurance. Crucial charitable, educational, and religious services these entities offered were endangered.

As insurance premiums skyrocketed regardless of loss history, educational institutions became one casualty of this disaster. Schools and colleges had difficulty finding liability insurance, and the little that was available was astronomically expensive and ill-suited to their needs.

Charities were casualties as well. ANI's President & CEO, Pamela Davis, testified about her graduate research before the California Assembly in 1987:

> Between 1984 and 1986, general liability insurance premiums increased 200 percent or more for one out of four charitable nonprofit organizations in California. During that same period, insurance companies canceled or refused to renew the general liability policies of one out of five California charitable nonprofits. Some important human service programs, such as childcare, foster care, group homes and health service were forced to dramatically cut services or close because they couldn't find affordable insurance.

Congress passed the 1986 Amendments to the Risk Retention Act to address the challenges nonprofits, charities, churches, universities, and small businesses were facing in obtaining liability insurance. The House Committee on Energy and Commerce vividly described the bleak national landscape for insurance:

> During the 99th Congress, the country has been shaken by a crisis in the availability and affordability of commercial liability insurance. Congress has been besieged with complaints regarding huge rate increases, mass cancellations of coverage, and entire lines of insurance virtually unavailable at any price. Crucial activities and services have been hard hit. Such activities include, among others, those of municipalities, universities, child daycare centers, health care providers, corporate directors and officers, hazardous waste disposal firms, small businesses generally, and many others.

House Report 99-8655, page 7.

The answer to this crisis was an expanded role for RRGs, which are unique, industry-specific groups of similarly-situated entities, with similar risk exposures, that pool their risk to self-insure their liability risks on a group basis. Initially, RRG's were authorized to offer product liability insurance in 1981. In passing the 1986 Amendments permitting RRGs to offer all lines of liability insurance (save for workers' compensation insurance), Congress recognized that RRGs could increase the nation's insurance capacity and moderate the dramatic cycles of commercial insurance.

Supporters of the 1986 Amendments expressed the belief that allowing risk retention groups to provide all types of commercial liability insurance would foster rational underwriting and insurance pricing. They anticipated a positive, overall increase in the nation's insurance capacity and some moderation of the painful cycles in the availability of insurance from commercial carriers.

The House Committee report explained the expected benefits of the proposed amendments:

> Since a risk retention group is simply a group of businesses or others who join together to set up their own insurance company only to issue insurance policies to themselves, it was believed that by encouraging such groups, the subjective element in underwriting could be reduced. The risk retention group would know its own loss experience and could adhere closely to it in setting rates. It was also believed that the 1981 Act, by providing alternatives to traditional

> insurance, would promote greater competition among insurers to "encourage private insurers to set rates to reflect experience as accurately as possible."

House Report 97-190, page 4.

> ...the Committee believes that creation of self-insurance groups can provide much-needed new capacity. Additionally, according to the Department of Commerce, "[t]he knowledge that substantial insurance buyers can create their own alternative insurance mechanisms will be an incentive to commercial insurers to avoid sharp peaks and valleys in their costs."

July 17, 1986, Congressional Record, pages S9229-S9230, letter of Douglas A. Riggs, General Counsel, Department of Commerce, dated June 25, 1986.

C. The LRRA Success Story

Congress was correct in assuming that RRGs would add capital to the insurance market, successfully moderate insurance pricing and provide a stable source of insurance coverage for universities, nonprofits, professionals and small businesses. In the more than a quarter century since the 1986 LRRA Amendments, more than 250 risk retention groups have aggregated more than $2.5 billion in gross written premiums. RRGs have, in the intervening time, written liability coverages for focused markets, garnering strong industry knowledge and employing state-of-the-art risk management and training programs that have lowered risk and limited loss.

The focused approach of RRGs has resulted in aggregate operating performances that are, according to rating agency A.M. Best, "consistently better than that of their peer group in commercial insurers." A.M. Best found that RRGs outperformed their commercial counterparts in incurred loss and loss-adjustment expense ratios, combined ratios, and net investment ratios.

1. RRGs Provide Tailored Coverage with Stable Pricing for Their Industry's Unique Risks

Since its inception, National Catholic has demonstrated leadership in the insurance industry by the creation and provision of insurance coverage tailored to the needs of Catholic Church ministries. For example, when some Catholic Social Services entities were unable to find appropriate coverage for

low income housing they were rehabilitating, National Catholic created policies that covered risks associated with lead and fungal pathogens. Other unique but necessary lines of coverage created by National Catholic include teaching and research laboratory pollution coverage, chemical and agricultural drift pollution coverage, limited professional health care services coverage, diocesan review board coverage, innocent person defense costs reimbursement coverage, volunteer attorney errors and omissions liability coverage, computer-related liability coverage, and sexual misconduct limited coverage (which no carrier was underwriting when National Catholic first offered its full policy limits for this exposure).

When National Catholic initiated operations, there were literally less than a handful of insurers that would underwrite nonprofit entity directors' & officers' (D&O) coverage, and the premiums charged by those carriers were unaffordable. By contrast, at the time, National Catholic offered D&O Coverage as a "throw-in" at no additional premium charge.

Many Catholic Churches host a myriad of athletic events, including sports camps, Catholic Youth Organization (CYO) leagues, cheerleading, and physical education classes. At the time of National Catholic's inception, athletic participation coverage was largely unavailable and unaffordable. However, National Catholic offered full limits coverage with no related surcharge.

In addition, National Catholic offered employment practices liability (EPL) coverage from its first day of operation in 1988 even though the overall insurance industry did not start broadly writing this coverage until about 1994. Finally, in its 27-year history, National Catholic has never restricted or reduced previously granted coverage in National Catholic policy forms – it has only expanded its coverage terms and conditions.

Similarly, a standard liability package through United Educators provides coverage for risks such as sexual assault, sexual molestation, international study, and sports injuries, which is often unavailable through other insurers but critical to educational institutions. United Educators also offers an educators legal liability policy, which provides broad protection against a wide range of potential claims that are unique to education such as denial of tenure and failure to educate. Likewise, ANI offers general liability, improper sexual conduct liability, auto liability, social services professional liability, and directors and officers liability, including employment practices - - insurance coverage essential to tax-exempt organizations. All three RRGs have had their share of large "shock losses", ranging from

sexual abuse by trusted figures to fatal van accidents and the deaths of children in foster care. Traditional carriers opportunistically come in and out of these markets, creating instability and inefficiencies. In contrast, all three of these RRGs are strong and consistently continuing to meet the ever-changing needs of their members.

2. RRGs Deliver Industry-specific Risk Management Services

Because RRGs serve a single industry, unlike a traditional insurance carrier that must serve many industries, RRGs are able to develop risk management practices and materials that are tailored to their members.

Since its inception, United Educators has been a thought leader in addressing risks that are unique to education. For example:

- When the Virginia Tech mass shooting set a new bar for risk management and student safety, United Educators immediately conducted a telephone roundtable on random violence in education settings and held a symposium featuring an interdisciplinary panel of experts who developed recommendations about threat assessment programs, student mental health, and key crisis response issues.
- Recently, Robb Jones, United Educators Senior Vice President and General Counsel for Claims Management, and two United Educators Board members were among the 60 policy experts, students, and survivors of sexual assault invited to the White House as part of the work of the White House Task Force to Protect Students from Sexual Assault. This Task Force was created by Executive Order on April 22, 2014, and is co-chaired by the Office of the Vice President and the White House Council on Women and Girls. It is charged with sharing best practices and increasing transparency, enforcement, public awareness, and interagency coordination to prevent violence and support survivors.
- United Educators is also a leader in the effort to raise awareness of traumatic brain injury (TBI) in sports, to change behavior, to keep student athletes safe and, ultimately, to reduce TBI claims.

United Educators members have access to a wide variety of practical, education-specific resources, including online courses and other risk management tools, to improve their awareness of liability

issues and to strengthen their ability to avoid or control losses. United Educators risk management advice often bridges liability and property issues, which are often intertwined. For example, United Educators helped educational institutions devastated by Hurricane Katrina. And United Educators risk management training led to the successful evacuation of students during wildfires on the Westmont College campus in California, keeping students safe and reducing the damage to campus buildings.

Like United Educators, ANI provides free risk management services to its nonprofit members, including driver training, employment-related and pre-termination consultations, a treasure trove of online risk management materials, an audiovisual library, webinars, and online board tools. It also offers other essential services to nonprofits such as background checks, disaster recovery and planning, drug screening, and motor vehicle record checks at cost or at a substantial discount.

National Catholic, owned by its shareholder Catholic entities, also employs highly-experienced professionals who understand and share the values of the Catholic Church as they develop sound solutions for optimal risk management. Its VIRTUS® programs are the foundation of the risk management initiatives undertaken by National Catholic on behalf of its shareholders and the broader Catholic Church. Its programs continue to lead the industry with a wide variety of innovative products, positioning itself as the foremost provider of safe environment services for the Catholic Church in the United States and as an emerging force for good internationally.

National Catholic offers free risk management and legal defense workshops to numerous dioceses throughout the country. Its annual winter meeting features seminars on risk management topics of critical importance to the Church. These workshops and the annual winter meeting are provided free for all Church representatives, both diocesan employees and religious institute members and employees, even if they are not associated with a National Catholic shareholder.

National Catholic also offers its Critical Conversations™ program, an educational training and prevention program that presents case studies for priests, deacons, and lay ministers. In addition, it provides its members with specialized risk management materials relating to athletic participation, crisis planning, and business continuity.

D. The Time is Right for Congress to Act Again

Now is the time for Congress to take the next step and increase insurance capacity by modernizing the LRRA to include other lines of commercial insurance such as property, fleet auto physical damage, business interruption, and cyber risk insurance.

Doing so would increase market competition for property and other types of coverage and facilitate more effective, segment-specific pricing. Too often, churches, charities, educational institutions, and other organizations find themselves under-insured when the typical commercial carrier fails to understand the issues RRGs handle on a regular basis – such as swimming pools on campus, stadiums, and the use of vehicles by students or volunteers.

Moreover, entities insured by RRGs that must buy property insurance from traditional carriers may be adversely affected by trends involving natural disasters such as tornadoes. Traditional commercial carriers understandably react to changing weather patterns and consequent catastrophic losses with much higher pricing, deductibles, or even refusal to continue to provide coverage for certain natural disasters in certain geographic zones.

In contrast, as member-owned entities, RRGs proactively address tough coverage realities through risk-based research, actuarial-based pricing, and coverage levels that are designed to be sustainable. And, any resulting profits are passed on to members, keeping their operating expenses down.

Property: The focus of an RRG on an industry's unique risks means that the RRG will understand the property risks of its members better than conventional insurance carriers will. For example, National Catholic understands the church buildings and artifacts owned by churches, just as United Educators understands the physical plant of a school or university; this level of understanding often is not available from traditional insurance carriers.

Examples of ways that property coverages for churches, nonprofits, and educational institutions differ from other commercial enterprises include:

- ***Budgeting***: A property carrier may demand certain changes within 90 days. If the demand, though, covers an issue such as retrofitting churches or dormitories with sprinklers, the church's or college's budget process and occupancy schedules generally cannot operate on a 90-day schedule.
- ***Coverage***: Existing business interruption coverage is generally ill-suited to churches, nonprofits, and tuition and state-supported educational institutions.
- ***Property valuation***: Many churches and campuses have one or more historic buildings, for which property coverage at restoration value may be more appropriate than replacement cost.
- ***Varying deductibles by department***: Various academic departments use different types of equipment. The biology department may need a low deductible on expensive laboratory equipment that would have to be replaced out of its own budget; the English department would not be faced with such high replacement costs for equipment.

Other Property Coverages: The same principle applies when churches, educational institutions, nonprofits and other RRG members have to obtain separate policies to cover embezzlement, computer equipment, and office furniture. It is inefficient and unnecessary to force these entities to obtain these coverages in one or more separate, stand-alone policies, unless they choose to forego the tailored coverage and focused risk management that an RRG can provide them.

Cyber Risk: In February 2014, the Department of Homeland Security (Homeland Security) launched its C3 Voluntary Program, a public-private partnership aligning business enterprises as well as federal, state, and local governments. The C3 Voluntary Program was designed to assist Homeland Security in using the recently-released National Institute of Standards and Technology Cybersecurity Framework (NIST Framework) to manage cyber risks as part of an all-hazards approach to enterprise risk management (ERM). So far this year, Homeland Security has held four workshops with the insurance industry, risk managers, and security experts. According to Homeland Security, although insurance companies offer coverage for the liability side of cyber risk (such as notification and credit monitoring), there is a large market void for the property portion of the risk.

The goal of the workshops was to find ways to conduct cyber risk consequence analysis and to model risk so that insurers can understand cyber risk and price it. The workshops have attempted to identify ways to share cyber incident information in an anonymous way to build actuarial tables for underwriters to price coverage and for risk managers to develop programs to minimize cyber risk. Although many large corporations are adopting the NIST Framework in light of the recent security breach of a major national retailer, Homeland Security is concerned about its ability to reach small- to medium-sized businesses.

RRGs, with their dual mission of providing insurance and industry-specific risk management, can reach many of those small businesses and nonprofits that Homeland Security hopes to reach. For example, if RRGs were permitted to write the other commercial components of cyber risk such as property and business interruption insurance, RRGs could reach many of those smaller businesses and nonprofits by not only providing cyber risk insurance covering property and liability risks, but by providing industry-specific ERM pursuant to the NIST Framework.

E. The Case for Modernization of the LRRA

A recent survey of insurance agents revealed that 83% were convinced that United Educators could price its products to a loss ratio that was below market due to its excellent risk management and education tools if it were permitted to write the full line of commercial products such as property and auto physical damage.

Permitting established RRGs with adequate capital and surplus to offer other forms of commercial insurance to their members, such as property, auto physical damage, business interruption insurance, and cyber risk, will add capital to, and increase competition in, the property and casualty insurance market. Nonprofits, small schools, churches, and other small businesses that are accustomed to purchasing package insurance policies will be able to obtain package policies without foregoing the customized coverage and risk management services offered by RRGs. These small entities, as well as their independent brokers and agents, will gain efficiencies through the availability of package policies from RRGs.

Because RRGs have a deep understanding of the unique risks facing their members, modernization of the LRRA will facilitate improved coverage and superior risk management for other lines of commercial insurance for churches, educational institutions, nonprofits, medical groups, and others who purchase insurance through RRGs. Allowing RRGs to write additional lines of commercial insurance also will reduce the overall cost of risk for these organizations that have shown a commitment to each other and to risk management. Finally, modernization of the LRRA will insulate members of RRGs from the cyclical nature of the property insurance market.

There may be some misunderstanding about what the LRRA modernization legislation will do and won't do. The discussion draft before the Subcommittee today would modernize the LRRA to permit only established RRGs with adequate capital and surplus to offer other forms of commercial insurance, beyond the commercial liability insurance currently permitted under the LRRA.

Our bill would permit RRGs to offer other forms of commercial insurance only if:

1. The RRG has been chartered or licensed as an insurance company under the laws of a state and authorized to engage in the business of insurance pursuant to that state's law;
2. The RRG has provided commercial liability insurance pursuant to such charter or licensing for a period of not less than five (5) consecutive years; and
3. The RRG maintains capital and surplus of at least $5,000,000.

As drafted, the LRRA modernization legislation will ensure that the RRGs that qualify and decide to offer other forms of commercial insurance will do so to the benefit of their members, but only their members. The modernization provisions included in the discussion draft will create efficiencies for members of RRGs that will no longer be forced to seek additional coverage elsewhere and will insulate members of the RRGs from rate volatility associated with the cyclical nature of the larger commercial insurance market.

We know that there are traditional insurance companies and some insurance commissioners that see RRGs as a threat. This argument was made in 1986 and in some quarters continues to be made. However, RRGs are an innovative and highly-specialized way to offer small businesses and nonprofits more choice. They bring new capital to the market, keep prices down, and are rooted in stated-based regulations. We believe in the capitalism system and competition. While we acknowledge some might

not like new entrants into the market, if they are well managed, well capitalized, and serving customers, we say this is the American way and we want to be part of it.

We are aware that some organizations that are concerned about the increased competition that modernization of the LRRA will create have labeled this competition as "unfair" competition. However, the truth is that the modernization legislation will add capital to the market and increase competition by offering more choice to the small portion of the market that RRGs serve such as nonprofits, churches, and small educational institutions.

Our bill is about increasing the availability of coverage and tailored risk management services to specific industry segments. It does so without giving RRGs any unfair advantage. RRGs have flourished not because of a lack of multi-state regulation. Instead, they have succeeded at a rate higher than conventional insurance carriers because of their mission-driven focus, tailored coverages, increased levels of specialized risk management, and their ownership by their members.

To the best of my knowledge, major conventional stock and mutual property insurance carriers have not chosen to sell to single industries. Traditional stock and mutual insurance property casualty insurance carriers serve any and all customers from any and all industries, while RRGs cannot. Lacking public shareholders, RRGs are limited to a concentrated focus on a single industry with an obligation to its owner insureds.

Given that RRGs are not seeking the ability to insure multiple industries, expansion of the LRRA to include other commercial coverages does not create any unfair advantage. Instead, it maintains all the checks and balances that Congress put in place in 1986 when it authorized groups of similarly-situated insureds to join together to insure their own risks as an RRG.

It is also important to note that RRGs are now subject to the National Association of Insurance Commissioners (NAIC) state accreditation requirements. To be accredited, a state must have in place and in force laws and regulations that relate to financial solvency. All states are now accredited by the NAIC. Accordingly, RRGs are subject to the same accreditation standards as other insurance companies.

The LRRA modernization legislation does not seek to upend the LRRA. The proposed legislation does not:

- Authorize RRGs to offer personal lines of insurance;
- Authorize RRGs to offer group health, life, or disability insurance or workers' compensation insurance;
- Authorize RRGs to be subject to guaranty fund coverage;
- Alter domiciliary state solvency regulations nor state accreditation standards;
- Alter non-domiciliary state solvency regulations imposed on non-domiciled RRGs registered in those states or in any way alter a non-domiciliary state's current ability to call for an examination of an RRG nor call for compliance with any lawful orders of delinquency should an RRG be found to be financially impaired;
- Absolve an RRG's responsibility to comply with an injunction issued by a court upon the petition by a state insurance commissioner if an RRG is found to be in a hazardous financial condition or financially impaired;
- Waive an RRG's responsibility to comply with state laws regarding deceptive, false, or fraudulent acts or practices;
- Affect an RRGs current requirement to comply with unfair claims settlement practices laws; or
- Absolve an RRG from payment of applicable state premium taxes.

Instead, the amendments proposed to the LRRA by the modernization legislation will simply permit RRGs to offer their members – and only their members – the same comprehensive commercial insurance packages that are the norm in today's commercial marketplace, particularly for nonprofits and small educational institutions, without foregoing the customized coverage and risk management services offered by RRGs.

Some suggest that the unavailability today of certain lines of commercial insurance (or of typical commercial insurance package policies) for smaller entities like nonprofits and certain educational institutions does not rise to the same crisis level of the hard market of the 1980's. However, if RRGs truly were only a response to a crisis in capacity for liability insurance market, the industry would have shrunk when more capacity came into that market. That has been far from the case.

RRGs have demonstrated that, for certain types of organizations, collectively insuring each other is superior to relying on the traditional commercial insurance sector. RRGs can bring more capital to the current property casualty insurance market, thereby filling the unique needs of nonprofits, educational institutions, and churches while fostering healthy competition.

F. Conclusion

The genius of Congress' enactment of the LRRA is vividly demonstrated by the successes of United Educators, ANI, National Catholic and other risk retention groups, including the Housing Authority Risk Retention Group, ALPS, ALAS, and many others. RRGs have succeeded because Congress recognized that commercial insurance purchasers know better than anyone else their own risks and needs. In requiring that risk retention groups be owned and controlled by their policyholders who are homogenous groups, Congress also assured that the operation of the risk retention groups would consistently be in the best interests of their members.

Risk retention groups cannot solve all of the problems that exist in the commercial insurance market in America today. They are not a solution for homeowners and will not instantaneously provide coverage for all coastal institutions. Nevertheless, modernization of the Liability Risk Retention Act to include other commercial insurance lines such as property, fleet auto physical damage, business interruption, and cyber risk will create additional capacity to deal with natural as well as man-made catastrophes. Appropriate underwriting, capital, and risk management - fortes of RRGs - will continue to be in place to ensure long-term viability.

Thank you very much for the opportunity to address the Subcommittee on this important issue.

STATEMENT OF

THE AMERICAN COUNCIL OF LIFE INSURERS

BEFORE THE

SUBCOMITTEE ON HOUSING AND INSURANCE

OF THE

HOUSE COMMITTEE ON FINANCIAL SERVICES

ON

LEGISLATIVE PROPOSALS TO
REFORM DOMESTIC INSURANCE POLICY

May 20, 2014

Statement Made by
Gary E. Hughes
Executive Vice President & General Counsel
American Council of Life Insurers

Chairman Neugebauer, Ranking Member Capuano and members of the Subcommittee, my name is Gary Hughes, and I am Executive Vice President and General Counsel of the American Council of Life Insurers ("ACLI"). ACLI is the principal trade association for U.S. life insurance companies with approximately 300 member companies operating in the United States and abroad. These companies offer life insurance, annuities, reinsurance, long-term care and disability income insurance, and represent more than 90 percent of industry assets and premiums.

ACLI appreciates the opportunity to provide you with its views on several legislative initiatives addressing the way in which insurance is regulated in the U. S. The focus of our testimony today, however, is on H.R. 4510, the Capital Standards Clarification Act of 2014 introduced by Representatives Miller and McCarthy. Passage of H.R. 4510 is one of the very highest priorities for ACLI and is essential in order to ensure that evolving capital standards both here and abroad protect and preserve the ability of life insurance companies to offer retirement and financial security products benefiting millions of U.S. consumers.

H.R. 4510 - The Capital Standards Clarification Act of 2014

Background

Through authorities provided in the Dodd-Frank Act, the Federal Reserve Board now regulates at the holding company level a number of companies that are primarily life insurers. The Dodd-Frank Act granted the Federal Reserve new supervisory authority over savings and loan holding companies (SLHC's), including those which are, or own, life insurers. The Dodd-Frank Act also authorized the Federal Reserve to supervise nonbank financial companies designated as Systemically Important Financial Institutions ("SIFIs") by the Financial Stability Oversight Council (FSOC). As we noted in testimony before this Subcommittee in February, two of ACLI's member companies have been designated by FSOC as systemically important and one additional company is under review for possible designation. Twelve of our member life insurers own thrifts. All of these life insurance companies will be subject to whatever capital standards the Federal Reserve ultimately determines to impose under powers conferred on it by Section 171 of the Dodd-Frank Act (the Collins Amendment).

In July of 2013, the Federal Reserve issued a final rule implementing Basel III for Bank Holding Companies and Savings & Loan Holding Companies. This rule included a temporary exemption for insurers that are, or are owned by, SLHCs to allow for further evaluation of appropriate consolidated standards for those companies. Similarly, the Federal Reserve's February 2014 rule implementing enhanced prudential standards for SIFI's (Section 165 of the Dodd-Frank Act), explicitly does not apply to insurers so that the Federal Reserve can study and develop appropriate standards for those companies. However, as a result of section 171 of the Dodd-Frank Act, it remains unclear how or if the Federal Reserve will apply Basel III to those insurers. ACLI adamantly and strongly opposes any application of bank-centric capital standards such as Basel III to life insurance companies.

Life Insurers Strongly Support Appropriate Capital Standards

ACLI strongly supports appropriate rules intended to ensure the capital adequacy of insurance companies. ACLI believes that any consolidated capital standards developed by the Federal Reserve for insurance companies must be insurance-based capital standards modeled on the current insurer risk-based capital system (RBC). RBC was specifically designed by insurance regulators for insurance company entities and is a holistic, comprehensive and accurate measure of their unique risks.

RBC recognizes the unique characteristics of insurance companies' business models and balance sheets, which are very different from those of banks. Specifically, it recognizes that premiums are collected in advance and invested ahead of anticipated claims, that insurers have relative predictability of those claims, and that products have safety mechanisms such as surrender charges to protect against illiquidity. Unlike banks, which are typically exposed to large amounts of highly liquid demand deposits, insurers have longer-term liabilities and therefore find that longer-term assets, even those with higher short-term volatility, pose less risk and are a key component to the long-term viability and financial strength of an insurer.

In addition to capturing credit risk of fixed income investments and the risk of fair value losses from equity (and similar) investments, RBC also captures many other risks, such as asset risk, insurance/underwriting risk, interest rate risk, and business risk, as well as differentiating

between insurance industry structures (life, property & casualty, and health). Over more than twenty years, RBC has been and continues to be repeatedly reviewed and refined, reflecting changing conditions and increasing sophistication of modeling techniques.

The foundation of RBC is statutory accounting where both assets and liabilities are valued conservatively. This results in an appropriately prudent measure of surplus as the starting point for the RBC calculation. Statutory accounting also takes a long-term oriented asset/liability matching posture that appropriately incents insurers to invest for the long term. It intentionally avoids application of fair value accounting rules to most life insurance company assets, thereby avoiding unwarranted volatility in regulatory capital. Such short-term volatility is usually inappropriate, particularly for life insurers that typically have long-term and inherently stable liability structures.

All U.S. insurance companies currently prepare statutory accounting statements, as is required by law in all jurisdictions, whereas many life insurance companies do not prepare GAAP-based financial statements. Requiring GAAP-based financial statements coupled with a bank-centric capital adequacy regime would unnecessarily result in an additional and competing set of financials and capital measures for many companies.

The ACLI believes the insurance-based principles and methodologies of RBC must be the model for any Federal Reserve rulemaking on consolidated capital standards for the insurance companies under its supervision. Insurance-based capital standards would provide the Federal Reserve with the best measure of the capital adequacy and risks unique to insurance operations.

Bank Standards Are Not Appropriate for Insurers and Insurer Supervision

The Basel capital framework is designed specifically for banks by bank regulators. It was never intended to be applied to insurance companies and it would be inappropriate to do so. A bank-centric Basel framework is disconnected from the risks specific to insurance and would provide a distorted view of the financial strength or weakness of an insurance company. In short, life insurance companies have significantly different business models, risk profiles, and capital structures than banks.

Life insurers provide coverage to customers for their long-term risks, and their regulation requires them to match those long-term, illiquid liabilities with appropriate assets to ensure that those liabilities can be met. Current life insurer capital requirements directly reflect the level to which an insurer has matched the duration of its assets to the duration of its liabilities. This business model is fundamentally different than that of banks, where assets and liabilities are not matched and where the institutions are more dependent on short-term, on-demand funding, and are thus potentially subject to a "run" in periods of stress. Banking capital requirements implicitly assume this inherent mismatch. The business models, risk profiles and capital structures of life insurers and banks are so divergent that it would be incongruous to attempt the application of a single, one-size-fits-all capital standard to both.

The application of a bank-centric Basel framework to insurers would very likely have the opposite effect of that intended, disrupting sound insurance companies and incentivizing the wrong activity. The application of bank-centric capital standards to insurance companies would harm the risk management frameworks that insurers have in place to manage the risks that arise from their traditional business. Bank-centric standards would harm the ability of life insurers to perform their fundamental business of delivering long-term, guaranteed financial security products to millions of families and retirees. Disrupting the operations of well-run life insurance companies is completely at odds with the purposes of the Dodd-Frank Act and should not be permitted to occur.

The Dodd-Frank Act Authorizes the Federal Reserve to Apply Equally Robust Insurance Capital Standards

ACLI believes that Section 171 of the Dodd-Frank Act enables the Federal Reserve to apply insurance-based capital standards to meet the requirements under that section. Section 171 provides that the risk-based and leverage capital requirements "shall not be less than" nor "quantitatively lower than" the generally applicable minimum requirements under Basel III. This language clearly empowers the Federal Reserve to apply insurance-based standards similar to insurance RBC so long as they are not "less than" nor "quantitatively lower than" the minimum bank risk-based and leverage capital requirements. While ACLI continues to urge the Federal Reserve to exercise this authority by developing an appropriate RBC-based capital regime for

insurance entities, to date the Federal Reserve has declined to do so. The agency asserts that without congressional clarification, Section 171 compels it to apply Basel III standards to insurers.

The Importance of H.R. 4510

Given the Federal Reserve position that it does not have the statutory latitude to develop insurance-based capital standards for insurance companies, ACLI believes it is imperative for Congress to provide a legislative solution to this dilemma. For this reason, ACLI strongly supports H.R. 4510, legislation authored by Congressman Gary Miller and Congresswoman Carolyn McCarthy that would clarify the Federal Reserve's authority to develop insurance-based capital standards for the insurance companies under its supervision.

This common sense legislation would facilitate strong prudential supervision of insurance companies and at the same time prevent unnecessary disruptions in the insurance marketplace. ACLI looks forward to working with this Subcommittee and the full Financial Service Committee to advance this legislation. ACLI supports similar efforts in the Senate led by Senators Collins, Brown and Johanns, and we look forward to working with both houses of Congress to see that this critical legislation is enacted.

ACLI Views on Other Legislative Proposals

H.R. 4557, the Policyholder Protection Act of 2014

ACLI supports H.R. 4557, a bill that would afford insurance policyholders in the context of a savings and loan holding company the same protections as those currently provided under the Bank Holding Company Act. ACLI strongly supported language in the Gramm-Leach-Bliley Act constraining the ability of the Federal Reserve to compel movement of funds out of an insurance company that was part of a bank holding company in order to provide a "source of strength" to an affiliated insured depository institution if such action would jeopardize the interests of insurance policyholders. Extending this same protection to an insurer that is affiliated with a savings and loan association reflects sound regulatory policy.

H.R. 605, the Insurance Consumer Protection and Solvency Act of 2013

H.R. 605 would exclude insurance companies from the Federal Depository Insurance Corporation's "orderly liquidation authority." ACLI has no objection to this provision. During the pendency of the Dodd-Frank Act, ACLI supported language that would make clear that the FDIC's authority in the event of the insolvency of an insurance enterprise extended only to the insurance holding company and not to the regulated insurance affiliates or subsidiaries of that holding company. These regulated insurance entities would always be handled through the state-based insurance rehabilitation and liquidation process. H.R. 605 would also excuse insurance companies from any FDIC assessments to recover costs associated with the resolution of a "covered financial company." ACLI has no objection to this provision.

H.R. __, the Insurance Data Protection Act

This bill would modify the authority of the Federal Insurance Office and the Office of Financial Research to subpoena data from insurance companies. ACLI has not taken any position on this measure. As ACLI considered the data collection and subpoena powers of both the Federal Insurance Office and the Office of Financial Research during the pendency of the Dodd-Frank Act, our concerns were, and remain, assuring an efficient and non-duplicative process for collecting data on the insurance industry (e.g., not initiating separate federal data calls on insurance companies to secure information already in the possession of state insurance regulators) and assuring that data that is confidential in the hands of state insurance regulators retains that confidentiality should it be passed on to either of these two federal offices. We believe the provisions set forth in Sections 313 and 153 of the Dodd-Frank Act satisfy our concerns in this regard.

H.R. __, the Risk Retention Modernization Act of 2014

This bill would expand the authority of risk retention groups to offer other commercial lines of insurance. Since this pertains exclusively to property/casualty insurers, ACLI has no position on the measure.

Conclusion

ACLI's legislative priority in the House with respect to domestic regulatory policy remains the passage of H.R. 4510. The Federal Reserve must be afforded the flexibility to utilize insurance risk-based capital standards with respect to those insurance groups under its jurisdiction. These insurance standards are a proven, reliable, and comprehensive measure of an insurance company's financial strength. They have been developed over many decades by state insurance supervisors, provide the best measure of the capital needs of an insurer and are the best tool for the Federal Reserve to assess an institution's capital adequacy. Substituting bank-centric standards for insurance RBC standards undermines rather than enhances the supervision of insurance companies and would be at odds with efforts to enhance the stability of the U.S. financial markets. We look forward to working with this Subcommittee and with both houses of Congress to pass this important piece of legislation.

Statement

of

Tom Karol

National Association of Mutual Insurance Companies

to the

United States House of Representatives

Financial Services Subcommittee on

Housing and Insurance

Hearing on

Legislative Proposals to Reform Domestic Insurance Policy

May 20, 2014

Introduction

The National Association of Mutual Insurance Companies is pleased to provide testimony on a number of important legislative proposals that are of critical importance to the property/casualty insurance industry.

NAMIC is the largest and most diverse property/casualty trade association in the country, with 1,400 regional and local mutual insurance member companies on main streets across America joining many of the country's largest national insurers who also call NAMIC their home. Member companies serve more than 135 million auto, home and business policyholders, writing in excess of $196 billion in annual premiums that account for 50 percent of the automobile/ homeowners market and 31 percent of the business insurance market. More than 200,000 people are employed by NAMIC member companies.

We are pleased that the committee is focusing on issues related to the property/casualty insurance industry, which is highly competitive, well capitalized, and a key pillar in the strength and resilience of the American economy. The property/casualty insurance industry pools the liability, property and casualty risks of U.S. businesses and consumers, enabling them to profitably engage in commerce. Property/casualty insurers pay out more than $400 billion each year in policy benefits, helping individuals and businesses rebuild their lives. The industry also contributes to the growth and stability of the economy by investing more than $1.4 trillion, principally in corporate and government bonds and stocks; serves as a major source of capital for state and local governments; and generates 2.3 million U.S. jobs, more than one-quarter of which are directly employed by insurance companies. The property/casualty industry is unique among the financial services industry and it is imperative that policies are adopted that do not needlessly disrupt one of the well-functioning bedrocks of our financial structure by adding additional costs or creating competitive disadvantages.

The committee is examining a number of legislative proposals that would directly impact the property/casualty industry. NAMIC appreciates the opportunity to offer comments on each of the following proposals.

> H.R. 4510, the Insurance Capital Standards Clarification Act of 2014, which would afford the Federal Reserve greater flexibility to apply accurate capital standards for insurers.
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> H.R. 605, the Insurance Consumer Protection and Solvency Act of 2013, which would clarify that the FDIC does not have the authority to assess insurance companies for the Orderly Liquidation Authority ("OLA").

H.R. 4557, the Policyholder Protection Act of 2014, which would extend the policyholder protections of the Bank Holding Company Act to bank-affiliated insurance companies organized as thrift holding companies.

H.R. __, the Insurance Data Protection Act, which would revoke the authority of the Federal Insurance Office ("FIO") and the Office of Financial Research ("OFR") to subpoena data from insurance companies, and,

H.R. __, the Risk Retention Modernization Act of 2014, which would expand the authority of risk retention groups to offer other commercial lines insurance.

H.R. 4510, the Insurance Capital Standards Clarification Act of 2014

The Insurance Capital Standards Clarification Act, or H.R. 4510, amends Section 171 of the Dodd-Frank Act (DFA) to clarify the application of capital requirements to insurance companies subject to supervision by the Federal Reserve Board.[1] Under the DFA, insurance companies that own savings and loan holding companies and insurance companies that are designated as "systemically important" by the Financial Stability Oversight Council are subject to supervision by the Federal Reserve Board. Section 171 of the Dodd-Frank Act separately requires that the Federal Reserve Board impose certain minimum leverage and risk-based capital requirements on the companies that it supervises. The Federal Reserve Board has interpreted Section 171 to require the application of bank capital rules (the so-called Basel III capital standards) to the insurance companies it supervises, despite numerous legal opinions that they have flexibility in this regard and the insistence of the author of the provision, Sen. Susan Collins of Maine, that she never intended to have bank capital standards apply to insurance companies. Sen. Collins and a number of members of the House and Senate have urged the Federal Reserve Board to adjust the capital standards for insurance companies to align with the business of insurance rather than the business of banking, but the Federal Reserve Board maintains that it is confined by the language of Section 171.

The Insurance Capital Standards Clarification Act resolves this question by stating that, in establishing the minimum leverage and risk-based capital standards under Section 171, the

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[1] Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, 124 Stat. 1376 (2010).

Federal Reserve Board or any banking agency is not required to include or consolidate in the depository institution holding company the assets and liabilities of any regulated insurance entity that is engaged in the business of insurance and is subject to state-based insurance capital requirements or capital requirements imposed by a foreign country. The legislative clarification is narrowly tailored and preserves the Federal Reserve Board's authority to impose capital standards on insurance companies under other provisions of Federal law, including the Board's authority in Section 165 of the DFA to impose heightened capital standards on nonbank financial companies designated by the Financial Stability Oversight Council for Federal Reserve Board supervision. All non-insurance activities of an insurance company supervised by the Federal Reserve Board would remain subject to bank capital standards.

This Act would make clear the legislative intent of Section 171, by recognizing that bank capital standards are not appropriate for insurance companies. It is widely acknowledged that insurance business risks are not the same as the risks associated with the business of banking. The risks in the business of insurance are not highly correlated to the macro-economic cycles and are found on the liability side of the balance sheet; existing capital standards imposed by state regulators appropriately address these risks by focusing predominantly on liability and underwriting risk. Banking risk, on the other hand, is based on the asset side of the balance sheet and includes credit, market, counterparty, and liquidity risk. Bank capital rules are designed to address these risks and ensure that a bank has sufficient funds meet depositor demands.

The Act also provides that the Federal Reserve Board shall not require insurance companies subject to Section 171, that only prepare financial statements in compliance with state-based statutory accounting rules, to also prepare financial statements in compliance with generally accepted accounting principles (GAAP). Since the early 1900s, state insurance regulators through the National Association of Insurance Commissioners (NAIC) have maintained their own accounting system, commonly known as statutory accounting principles (SAP). SAP are derived from GAAP, but are tailored with a regulatory focus on solvency to more accurately and more conservatively assess insurers than can be done using GAAP. Each insurer must use statutory accounting to file its financial statements with the regulators in those states in which the insurer is licensed to do business.

Although every publicly traded company, including insurers, must file GAAP statements with the Securities and Exchange Commission, many mutual insurance companies prepare financial statements using SAP only. Forcing such companies to prepare GAAP statements in addition to SAP is a labor intensive, multi-year project that will cost companies hundreds of millions of dollars without adding any benefit in regulating the company. The legislative history of the DFA is clear that insurance companies should be regulated as insurance companies, including explicit Senate Report language that such treatment should extend to accounting standards.

Despite clear congressional intent, the Federal Reserve has indicated on numerous occasions that its preference and intention is to force non-publicly traded insurance companies to adopt GAAP to conform with the Fed's standards in regulating banks. H.R. 4510 would reaffirm the congressional intent that in cases where a top-tier holding company is an insurance company itself and only files SAP financial statements in accordance with state law, the company should not be compelled to prepare GAAP financial statements. The clarification is necessary to ensure that the Federal Reserve does not impose needless new expensive and burdensome accounting requirements on insurance companies which would add costs for policyholder-owners, while providing no additional regulatory benefit.

NAMIC has provided Congressional testimony and numerous comment letters to the Federal Reserve Board and other regulators noting that bank capital standards are wholly inappropriate for insurance companies, and that the application of banking standards to insurance companies operates to the detriment of insurance policyholders, insurance companies and the stability of the financial system. NAMIC has also consistently defended the use of statutory accounting and opposed proposals to impose GAAP reporting. The Insurance Capital Standards Clarification Act is much needed legislation to resolve once and for all the issue of application of capital standards to insurers and the use of statutory accounting principles. NAMIC encourages the committee to move forward with adoption of the legislation as soon as possible.

H.R. 4557, the Policyholder Protection Act of 2014

The Bank Holding Company Act (BHCA) establishes procedural requirements for federal banking regulators seeking to transfer or move assets from an insurance company organized as a bank holding company (BHC) to a troubled affiliated bank.[2] Known as the "Source of Strength" doctrine, the BHCA requires that a BHC or Savings and Loan Holding Company (SLHC) or other non-BHC or SLHC controlling an insured depository institution serve as a source of financial strength for the underlying bank or association. Specifically, the BHCA prohibits the transfer of funds if the state insurance regulator notifies the holding company and the Federal Reserve Board in writing that such action would have a material, adverse effect on the financial condition of the insurance company. The act further requires the board to promptly notify the insurance regulator of the intent to seek the transfer of funds or assets from an insurance company.

Insurance companies are subject to very strict capital and reserving requirements, conservative accounting standards, and stringent investment rules to ensure they maintain the financial wherewithal to meet their financial obligations. State insurance laws and regulations create walls

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[2] Section 5(g) of the Bank Holding Company Act of 1956 (12 U.S.C. 1844(g))

around the licensed insurance operations of diverse financial firms to ensure that funds used to support the solvency and security of the insurance units are not raided to support non-insurance operations elsewhere within the control group. Even where a property/casualty insurer is held by a holding company that also holds other types of financial services companies, these regulatory restrictions designed to protect policyholders operate to "ring-fence" the property/casualty insurer's capital and protect it from incursions caused by problems in other subsidiaries. The solvency and financial security of the insurance company underlying its policies is the ultimate consumer protection. It is imperative that insurance assets are protected to pay claims.

The BHCA refers to BHCs and SLHC; however, most insurers affiliated with banks are organized as thrift holding companies, not bank holding companies. The laws governing thrift holding companies do not provide the same procedural protections as the BHCA. The Policyholder Protection Act of 2014 would amend the BHCA to provide the same protections for insurance companies organized as thrift holding companies.

NAMIC has long supported insulating the funds and assets of insurance companies within consolidated control groups. We remain concerned about any attempt to use insurance assets designed for the protection of policyholders and claimants to offset activities in other affiliated organizations. Tapping the assets, particularly without the consent of the insurance regulator, would inappropriately threaten the financial structure underpinning the insurance operations and undermine consumer confidence in the insurance industry. The BHCA protections should be extended to thrift holding companies and NAMIC supports H.R. 4557.

H.R. 605, the Insurance Consumer Protection and Solvency Act of 2013

The Insurance Consumer Protection and Solvency Act of 2013, or H.R. 605, clarifies that the Federal Deposit Insurance Corporation (FDIC) does not have the authority to assess insurance companies for the Orderly Liquidation Authority. The DFA created an orderly liquidation process, and Section 210 of the Dodd-Frank Act directs the Treasury Department to establish an Orderly Liquidation Fund (OLF) that will be managed by the FDIC. If the funds recouped from claimants are insufficient to satisfy the obligations to the Secretary, then the FDIC may assess "eligible financial companies" and certain other financial companies, as necessary, for the FDIC to repay obligations issued to the Treasury Secretary within 60 months of the issuance of such obligations. "Eligible financial companies" include any bank holding company with total consolidated assets equal to or greater than $50 billion and any nonbank financial company supervised by the Board of Governors.

The orderly liquidation process established by the DFA is designed to ensure timely, organized and orderly resolution of troubled financial institutions. However, the state-based resolution authority for insolvent property/casualty insurers is a thoughtful, methodical process with a superb track record of protecting insurance claimants and policyholders and the Act recognizes that insurance insolvencies should be resolved through that process. All states have

property/casualty insurance guaranty funds that safeguard their residents against the insolvency of a property/casualty insurer doing business in the state. In the event of an insurance insolvency in which there are insufficient funds to pay claims, state guaranty funds assess member insurers to pay obligations related to the insolvency. As such, the insurance industry bears the financial responsibility for its own liquidation regime and the state guaranty system continues to work well to protect consumers without the need for taxpayer bailouts.

In addition to the fact that the insurance insolvencies are resolved under a self-supporting system, there is near unanimous agreement that traditional property/casualty insurers pose no systemic risk to the nation's economy. The International Association of Insurance Supervisors, (IAIS) in its November 2011 report on Insurance and Financial Stability, found that "insurers engaged in traditional insurance activities were largely not a concern from a systemic risk perspective" as a result of the specific nature of the insurance business model and in the way insurance liabilities are funded and claims are settled.[3] In fact, the IAIS concluded that insurers provide "an important contribution to the financial soundness of banks and more broadly to financial stability." The findings were echoed by the 2011 Annual Report of the Financial Stability Council which found that "insurance institutions were only indirectly affected by the crisis" and that "the traditional U.S. insurance market largely functioned without disruption in payments to consumers throughout the financial crisis and the recovery."[4] Highlighting the performance of the insurance industry the same report found that "only 28 of approximately 8,000 insurers became insolvent in 2008 and 2009, and those insurers are being resolved pursuant to applicable state law."

As NAMIC made clear in its February 18, 2014 comments to the FDIC, under the DFA, the regulations defining the OLF must take into account the differences in risks posed to the financial stability of the United States by financial companies; the differences in the liability structures of financial companies; the different assessment bases for financial companies addressing their own industry liquidations; and consider specifically that insurance companies are already assessed pursuant to applicable state law for the costs of the rehabilitation, liquidation, or other state insolvency proceedings and contribute to guaranty funds to pay the losses incurred by policyholders of insolvent insurance companies. There is uniform recognition that property/casualty insurance companies and mutual companies in particular present almost none of the risk factors the FDIC is statutorily required to apply and that all insurance companies already meet guaranty fund obligations for the insolvencies in their own industry.

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[3] "Insurance and Financial Stability," International Association of Insurance Supervisors (IAIS), November 2011. <http://www.iaisweb.org/temp/Insurance_and_financial_stability.pdf>

[4] 2011 Annual Report, Financial Stability Oversight Council (FSOC), August 2011. <http://www.treasury.gov/initiatives/fsoc/Documents/FSOCAR2011.pdf>

It is not appropriate to assess insurance companies for the financial bankruptcies of non-insurance financial institutions, and NAMIC strongly supports H.R. 605. We urge the committee to act expeditiously to ensure that the nation's insurance consumers do not bear the financial responsibility for the failures of non-insurance financial institutions.

H.R. __, the Insurance Data Protection Act

Section 502(e) of the DFA grants authority to the Federal Insurance Office (FIO) to receive and collect data and information on and from the insurance industry and insurers, though it is directed to coordinate with federal or state regulators and research publicly available sources prior to requesting the information. The FIO is granted subpoena power subject to a written finding by its Director that the information is necessary and that the office has coordinated with the appropriate state regulator. The Office of Financial Research (OFR) is similarly granted subpoena authority to collect information.

The Insurance Data Protection Act would elevate the authority to subpoena information directly from insurance companies to the Secretary of the Treasury, strengthen the confidentiality protections for the information and require reasonable reimbursement for the costs of compliance with the data production.

Data calls and document productions are costly and time-consuming endeavors for insurers and raise issues related to the confidentiality and security of the information. Insurers regularly submit detailed information to state regulators on all aspects of their operations. Publicly traded insurance companies also provide data to securities regulators and government regulated exchanges. NAMIC has long supported and encouraged harmonization and coordination of the information requests among the states. Imposition of an additional reporting layer is counter to the goal of simplification and coordination. NAMIC recognizes the need for information at the federal level, but believes that collection of information should be limited.

The data collection and review mandates of the FIO and the OFR is expansive, and the amount and extent of the data potentially subject to these mandates is virtually limitless. While information to be learned about insurance through these information collection activities can be useful, neither the FIO, nor the OFR, serves in a regulatory capacity. As such, the information subject to their collection initiatives is not enforcement-related and is generally more long-term and academic in nature.

The Insurance Data Protection Act would not deny the FIO or the OFR any relevant information, but would ensure they take reasonable steps to prevent unnecessary and duplicative reporting by insurance companies. NAMIC believes that the reasonable safeguards proposed in the Insurance Protections Act in no way impede the functions of the FIO or the OFR and afford many of the

protections recently highlighted in the White House's Big Data and Privacy Working Group Review. NAMIC supports the Insurance Data Protection Act.

H.R. __, the Risk Retention Modernization Act of 2014

The Liability Risk Retention Act,(LRRA) enacted in the 1980s in response to a liability insurance crisis, effectively preempted state insurance laws and provided for the creation of risk retention groups (RRGs) to provide coverage in all U.S. jurisdictions. The LRRA currently permits RRGs to underwrite commercial lines liability coverage excluding workers' compensation, and does not apply to personal lines coverage. Under the Act, risk retention groups that meet certain licensing requirements of one state may operate nationwide. Except for the RRG's chartering state, the risk retention group is exempt from any state law, rule, or regulation that regulates or makes an RRG unlawful (with certain exceptions, including compliance with fraudulent trade practices regulations, nondiscrimination, and unfair claim settlement practices, and participation in state guaranty funds).

The Risk Retention Modernization Act proposes to expand the application of RRGs to all forms of commercial insurance other than group health, life, disability, or workers compensation insurance. We do not believe that current market conditions warrant a national and permanent expansion of RRGs into property or other non-liability insurance. The admitted market is fully capable of providing this coverage. Further, fair competition demands a regulatory environment that ensures that all businesses – large, medium and small – can operate according to the same set of clearly defined rules and standards. Unless competing parties abide by the same rules, competition becomes artificial and unbalanced.

Application of competition and regulatory principles in a manner that does not discriminate between or among economic entities in like circumstances and providing like goods and services is essential to a healthy, vibrant and competitive marketplace. The proposed legislation, by establishing different regulatory standards based on the corporate structure of the provider, does not meet the consistency and equality standards necessary to ensure fair competition. NAMIC, therefore, opposes the Risk Retention Modernization discussion draft.

Conclusion

NAMIC applauds the committee for considering a number of issues critical to the insurance industry. NAMIC urges the committee to support H.R. 4510, the Insurance Capital Standards Clarification Act of 2014; H.R. 605, the Insurance Consumer Protection and Solvency Act of 2013; H.R. 4557, the Policyholder Protection Act of 2014; and the Insurance Data Protection Act. We look forward to working with the committee to advance these proposals as expeditiously as possible.

Testimony of the Property Casualty Insurers Association of America (PCI)

Before the Committee on Financial Services, Subcommittee on Housing and Insurance

United States House of Representatives

Joseph C. Kohmann

Chief Financial Officer and Treasurer

Westfield Group

May 20, 2014

Thank you Mr. Chairman, Ranking Member and Members of the Committee for inviting PCI and the Westfield Group to testify on "Legislative Proposals to Reform Domestic Insurance Policy".

My name is Joseph Kohmann, Chief Financial Officer and Treasurer of the Westfield Group, which includes Westfield Insurance and Westfield Bank. Westfield Insurance has been in business since 1848 and has had an "A" or higher A.M. Best rating for the past 75 years. Westfield writes property casualty insurance in 31 states and has 1.8 Billion in statutory surplus. Westfield Bank is a five-star "superior" rated community bank by Bauer Financial. We are not a Wall Street Institution, but a very important regional provider of insurance and banking services to Main Street America.

I am testifying on behalf of Westfield and the Property Casualty Insurers Association of America (PCI), which is composed of more than 1,000 member companies, representing the broadest cross section of insurers of any national trade association. PCI members write more than $195 billion in annual premium and 39 percent of the nation's home, auto and business insurance, epitomizing the diversity and strength of the U.S. and global insurance markets.

PCI strongly supports the bills the Committee is considering today to clarify Congressional intent regarding the Dodd-Frank Act and we are very appreciative of the leadership of the Committee and the Republican and Democratic bill sponsors.

H.R. 4510, the Capital Standards Clarification Act of 2014

PCI strongly supports H.R. 4510, the Insurance Capital Standards Clarification Act of 2014 sponsored by Representatives Gary Miller (CA) and Carolyn McCarthy (NY) and 22 other members of Congress. In essence, this bill simply clarifies the original legislative intent of Congress in the Dodd Frank Act that in regulating insurance holding companies with banks or thrift affiliates, the Federal Reserve Board should apply bank capital standards to the banking portion and insurance capital standards to the insurance operations. It is the parallel bill to legislation by Senator Collins to clarify the intent of her amendment in the Dodd-Frank Act that the Board should not be required to impose capital standards designed for bank holding companies on the business of insurance. The Federal Reserve Board has indicated that application of bank holding company capital requirements to insurance companies is inappropriate and has delayed such imposition until Congress can rectify the situation, but the Board has testified that it does not believe it has interpretive flexibility under the Dodd-Frank Act if Congress does not provide relief. While PCI and Westfield and numerous Members of Congress disagree with the Board's limited statutory interpretation, it is essential that Congress address this imminent conflict.

Until 2011, savings and loan holding companies were regulated by the Office of Thrift Supervision (OTS). In 2011, pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), the supervisory responsibilities of the OTS were transferred to the Federal Reserve Board and savings and loan holding companies were subjected to much greater risk supervision, liquidity and capital requirements, not just for the thrifts or banks but also the broader holding company.

The Dodd-Frank Act imposes capital requirements on certain financial companies subject to regulation by the Federal Reserve Board including bank and savings and loan companies and entities such as insurers that have been designated as systemically important financial institutions (SIFIs) by the Financial Stability Oversight Council. These capital requirements may not be less than the capital requirements applied to banks generally, nor quantitatively lower than the bank capital requirements in place on enactment.

Numerous bipartisan members of the House and Senate have written to the Federal Reserve Board that Congress did not intend for the Board to impose bank capital standards on insurers. Senator Collins, the author of this language, has stated in writing to the federal banking regulators that "it was not Congress's intent that federal regulators supplant prudential state-based insurance regulation with a bank-centric capital regime.... [C]onsideration should be given to the distinction between banks and insurance companies...."[1] Federal Reserve Board Chairman Janet Yellen in recent congressional testimony agreed that the imposition of bank capital requirements to insurance groups owning a depository institution was an unintended consequence. Similarly, Board Members Dr. Stanley Fischer and Jerome Powell both testified in response to questions about the application of bank-like capital standards to insurers that there are differences between the bank and insurance models regarding capital needs but that the Board did not have statutory flexibility under the Dodd-Frank Act to accommodate such differences.[2]

H.R. 4510 provides additional flexibility to the Federal Reserve Board to establish appropriate capital standards for insurance companies subject to Board supervision. This important legislation allows the Board to apply strong, insurance-based capital standards to the insurers under its supervision, rather than inappropriate, bank-centric standards designed for banks.

Forcing bank capital standards onto an insurance company makes no more sense than imposing standards designed for auto insurers onto banks. They are fundamentally different businesses, with different risks, leveraging, and regulatory focus. For example insurance capital standards are designed to ensure consumer claims are protected. Federal Reserve Board capital standards are designed to prevent bank runs and protect economic stability as well as protect depositors, and regulate the entire bank holding company. While the Federal Reserve Board needs the ability to protect the soundness of the banking system and appropriately regulate companies under its supervision, this goal is not advanced in any meaningful way by imposing one-size-fits-all bank capital rules on holding companies that are primarily in the business of insurance.

The business and regulatory model of banking is fundamentally different from that of insurers with completely different risk profiles and capital needs. For example, unlike banking, there can be no "run" on the assets of a home, auto or business insurer. Other than payments for a covered loss, the only claim a policyholder can make on the assets of an insurer is for the return of unearned premium if the insured cancels a policy or requests a reduction in coverage – an action that would reduce rather than increase the insurer's net risk. Unlike some bank risks, insurance risks are not correlated with economic cycles. For example the occurrence of auto accidents or

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[1] November 26, 2012 letter from Senator Susan Collins to the Federal Reserve Board, Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency.

[2] March 13, 2014 hearing by the Senate Banking, Housing and Urban Affairs Committee.

storms are not correlated with economic downturns, unlike interest rates or lending defaults for banks, so insurance companies can actually provide an important anchor of security and risk diversification for the economy and insurance-bank holding companies. This was demonstrated throughout the recent financial crisis as property-casualty insurers emerged with near record levels of capital despite enduring the economic crisis and several major natural catastrophes.

Insurance companies are currently subject to rigorous, tailored capital requirements at the state level under the state risk-based capital (RBC) system. Risk-based capital was developed by insurance regulators to get away from fixed capital standards in order to tailor requirements based on individual insurer's risk profiles, condition and size. RBC analysis captures risk exposures specific to insurance companies, including asset risk, insurance/underwriting risk, interest rate risk, and business risk. Even within the insurance industry, insurance regulators tailor capital standards very differently for life, property and casualty, and health insurance.

In contrast, the banking capital framework focuses on measuring asset risk and is calibrated by regulators specifically for the asset profile of banks. The risk-weightings for bank assets are often inappropriate for insurance company assets due to the nature of insurance company liabilities, and the fact that insurance companies are significantly less reliant on borrowed debt (especially short-term debt) and therefore do not require the same level of liquidity as banks. Applying a banking measurement to insurance would fail to capture the primary risks while significantly overstating lesser exposures.

False measurements of risk imposed on insurers who happen to have depository institution affiliates do not benefit consumers or the economy in any way. In fact, consumers are already being harmed by the expected implementation of burdensome anticompetitive standards that are being arbitrarily duplicated from one sector and imposed onto a completely different industry, as compliance costs are increasing, capital is exiting the market, and new entrants are scarce, harming jobs, consumers and the economy. This is a poor result for a requirement whose sponsoring author agrees is being misapplied and whose regulator agrees is inappropriate.

While the Federal Reserve Board has acted prudently in delaying imposition of bank capital standards on insurers until Congress can rectify the situation, the potential burdens under the Dodd-Frank Act have already caused numerous insurers to exit the banking industry. Such affiliations can provide important community and customer services and provide additional diversity, competition and capital to the marketplace. Consumers and job growth are harmed if unnecessary regulatory costs force out critical Main Street capital providers.

H.R. 4510 correctly acknowledges that banking and insurance are not the same business, and that supervision of each should reflect their distinct business models. An insurance-based framework is best suited to manage insurance risks and safeguard the ability of insurers to meet their obligations to policyholders. We urge the passage of H.R. 4510 as soon as possible.

H.R. 605, the Insurance Consumer Protection and Solvency Act

PCI strongly supports H.R. 605, the Insurance Consumer Protection and Solvency Act, sponsored by Representatives Bill Posey and Kyrsten Sinema.

Preventing Conflicting Federal-State Liquidation of Insurers

H.R. 605 reflects Congressional intent that insurance company liquidations should continue to be conducted by state insurance regulators and not by the Federal Deposit Insurance Corporation (FDIC) under the Dodd-Frank Act.

Insurance companies are already subject to existing state resolution authority and guaranty funds that protect consumers. State regulators and guaranty funds have more than a hundred years of experience in managing and resolving or liquidating state regulated insurers and their subsidiaries, and it would be inappropriate and create potential conflict to provide for a federal bank resolution corporation to have additional authority to resolve insurers or their non-bank subsidiaries. The Dodd-Frank Act currently allows the FDIC to force a resolution of insurance companies that are part of a failed systemically important financial institution (SIFIs) and the insurer's subsidiaries if a state insurance regulator does not liquidate the covered financial companies within 60 days. The FDIC would "stand in the place" of the state regulator – an odd result that authorizes a bank federal deposit insurance corporation to become a temporary insurance regulator for insurance related insolvencies. H.R. 605 clarifies that an insurance company that is not a bank-holding company or a nonbank financial company supervised by the Federal Reserve Board (a SIFI) or a subsidiary of those entities is not a "financial company" subject to resolution by the FDIC.

Preventing Taking of Insurance Company Assets to Satisfy SIFI Failures

The Dodd-Frank Act currently allows the FDIC, when resolving a failed covered financial company (a SIFI), to reach into certain assets of the SIFI's insurance companies and their subsidiaries. Specifically, section 204(d)(4) of the Act permits the FDIC to take a lien on the assets of a covered financial company or its subsidiaries, but fails to exclude companies and subsidiaries that are insurance companies. State insurance regulators comprehensively regulate insurer investments to ensure that adequate capital and surplus are available to keep the insurer solvent and able to pay claims to policyholders. By giving the FDIC authority to take a lien against insurer assets without advance coordination with state insurance regulators, the Act creates a potential conflict with the ability of insurers to honor claims to policyholders, giving priority to claimants who are not policyholders.

H.R. 605 would bar the FDIC from placing a lien on an insurance company's assets without the written consent of the insurance company's domiciliary state regulator. The bill also makes it clear that the FDIC's authority under Dodd-Frank to place a lien on the assets of certain subsidiaries of a financial firm does not extend to insurance subsidiaries except in limited circumstances. Absent that clarity, Dodd-Frank could allow the FDIC to use insurance assets to cover losses of affiliated banks, even if that would cause the insurer to fail. State insurance regulators enforce strict capital and surplus requirements for insurers to protect policyholders, and the strong state regulation of solvency could be disrupted if federal regulators were allowed to "raid" insurance company assets to shore up other non-insurance affiliates without the approval of state regulators. By excluding insurers from the definition of "financial company," the bill limits the ability of the FDIC to take a lien on an insurance subsidiary.

Double Jeopardy for Insurers

Insurers already have a self-financed resolution system with insurance guaranty funds in every state that assess all licensed insurers in the state as necessary to protect policyholders in the event of an insolvency. In the last 40 years, property-casualty insurers have paid consumers trillions of dollars to fulfill claims and the insurance guaranty funds have provided an additional safety net of more than $21 billion on behalf of insolvent insurers. However, even though insurers are already required to pay into state insurance resolution funds to help ensure that policyholders of other failed insurers are honored, the Dodd-Frank Act allows the possibility that insurers could be held responsible for non-insurance failures, creating a significant one-way subsidy and moral hazard. In fact, insurers could be required to pay for the bailout of a systemically important financial institution (SIFI), and then if the resolution of that SIFI by the FDIC triggers a failure of one of its insurance subsidiaries, the insurance industry would be subject to a second assessment as a consequence of the failure caused by the federal bank regulator.

Because insurers are already responsible under state law for resolution costs within the insurance sector, they should not pay a second time at the federal level for resolution costs outside of the insurance sector. The Dodd-Frank Act does require the FDIC to use a risk-matrix in determining how to assess financial companies, and that matrix does include consideration of an insurer's payments of assessments into state guaranty funds. The matrix, however, does not preclude the FDIC (with federal responsibility for resolving bank insolvencies) from imposing a double resolution assessment on other state-regulated insurers, and the FDIC's assessments are likely to be prior to the timing of a state assessment.

H.R. 605 provides that insurance companies and their policyholders cannot unfairly be made to pay for the resolution costs of other non-insurance financial firms. No non-insurance firms pay into the state insurer guaranty funds. Under Dodd-Frank, certain insurers could potentially be subject to assessments for too-big-to-fail failures and asked to pay for the losses of federally supervised and highly risky and leveraged Wall Street firms, none of which will ever help to pay for insurer insolvencies. Not only would that be unfair, but it would create moral hazards by encouraging other financial entities to engage in risky activities knowing that insurance firms will have to help bail them out if they fail. H.R. 605 corrects this moral hazard.

H.R. 4557, the Policyholder Protection Act of 2014

PCI strongly supports H.R. 4557, the Policyholder Protection Act, sponsored by Representatives Bill Posey and Brad Sherman. This bill prevents federal bank regulators from transferring the assets of state regulated insurance companies and their subsidiaries to a bank if the state regulator determines such transfers would harm the financial condition of the insurer – essentially preventing bank regulators from putting state regulated insurers at risk to rescue banks. This protection currently exists for bank holding companies but was not included in the regulation of savings and loan holding companies under the Dodd-Frank Act.

The Dodd-Frank Act requires insurance companies to serve as a source of financial strength to affiliated depository institutions. Current law requires bank regulators to consult with state insurance regulators before requiring an insurer to serve as a source of strength for a bank

holding company. State regulators can prevent an insurer from serving as a source of strength by providing written notice to the board of the holding company that requiring such insurer to serve as a source of strength would have a material adverse effect on the financial condition of the insurer. However, that protection is not available when the insurer is a savings and loan holding company or is an affiliate of an insured depository institution.

Specifically, under 12 U.S.C. 1831o-1(a), a bank holding company (BHC) or savings and loan holding company (S&LHC) can be forced to serve as a source of strength for an FDIC-insured depository institution (hereafter "depository institution") subsidiary by the "appropriate Federal banking agency". In the case of a BHC or financial holding company (FHC) (but not an S&LHC) that is also an insurance company, under 12 U.S.C. 1844(g) no action by the FRB that requires the BHC or FHC to provide funds or other assets to a subsidiary depository institution is enforceable if the insurer's State insurance authority tells the Board in writing that requiring the insurer to serve as a source of strength would have a material adverse effect on the financial condition of the insurance company.

H.R. 4557 would provide the same protections for S&LHCs with insurance companies as is provided for BHCs – allowing insurance regulators to object to excessive capital transfers from the insurance affiliates to a bank. Specifically, H.R. 4557 would amend section 1831o-1 to provide that the exception in section 1844(g) for BHCs that are insurers will also apply to S&LHCs that are insurers, depository institution affiliates that are insurers, and any other insurer that directly or indirectly controls a depository institution

H.R. 4557 would also clarify more broadly with respect to insurance holding companies with a bank or other depository institution affiliate, whether the holding company is an insurer, an affiliate or controls directly or indirectly a bank, that if the Board requires such insurer to serve as a source of financial strength to the bank, it shall be deemed an `action of the Board that requires a bank holding company to provide funds or other assets to a subsidiary depository institution' for purposes of such section 5(g)' and thus subject to objection by the state regulator.

Insurance consumers should not be put at risk to protect bank investors. Federal bank regulators should not be given authority to take assets from insurance affiliates of banks any more than state insurance regulators should be allowed to demand assets from bank affiliates if either transfer would jeopardize the other entity.

The Insurance Data Protection Act

PCI strongly supports the proposed Insurance Data Protection Act, sponsored by Representative Steve Stivers. The bill makes some important clarifications regarding the appropriate protection on confidential data submitted by insurers to the Federal Insurance Office (FIO) and Office of Financial Research (OFR).

The bill will ensure that confidentiality applicable to information relating to insurance companies is not lost when that information is shared among various federal and state regulators. The Dodd-Frank Act now provides that privileged information retains its privilege when it is submitted to FIO, but it is less clear whether that privilege might be lost if FIO shares it with other federal or

state agencies. For example, Dodd-Frank authorizes FIO to disclose information to state regulators. The regulators would be bound by an information sharing agreement with the government, but a judge might later subject the information from the state regulators to a subpoena, taking the position that the information-sharing agreement applies only to the state regulator or the NAIC and not to the courts. There is no evidence that Congress intended that privileged information should lose its privilege when it is shared with other state or federal regulators.

The bill also limits the duplicative subpoena power of the OFR and FIO. The Dodd-Frank Act gave the OFR and FIO exceedingly broad subpoena powers, granted to federal agencies usually only for purposes of formal administrative proceedings, criminal or civil investigations or Inspector General investigations. The OFR and FIO have none of these functions. No suspicion of criminal or civil violations of a law or regulation is required and no formal administrative proceeding must be initiated. PCI is aware of no precedent for granting such broad subpoena powers to a federal agency in these circumstances. With respect to insurers, the OFR and FIO subpoena power also duplicates the powers that state insurance regulators already have to obtain information and data from insurers, either by subpoena or otherwise. Indeed, the Dodd-Frank Act requires FIO to coordinate with state insurance and relevant federal regulators on information that is available from them, and requires the OFR to "coordinate" with the relevant primary financial regulator. But coordination may ultimately not result in more than mere notification. Similarly, additional statutory considerations required of FIO such as a small business exception are undermined because the scope of such exceptions are ultimately determined by the Director without required approval by Treasury.

The Insurance Data Protection Act would require the OFR and FIO, before exercising such unusual subpoena power, to obtain approval of the Secretary of the Treasury. The Secretary must verify that the data is not available in a timely manner from existing regulators or public sources and to provide appropriate reimbursements as provided in federal regulations. This balance preserves the ability of the OFR and FIO to subpoena information not otherwise available while preventing duplicative and expensive demands that would normally be limited to a regulator or administrative proceeding.

Conclusion

We appreciate the committee's work on these bills and would be pleased to work with members of Congress towards their enactment.

TESTIMONY OF DANIEL SCHWARCZ

Associate Professor and Solly Robins Distinguished Research Fellow,

University of Minnesota Law School

before the House Housing and Insurance Subcommittee

regarding "Legislative Proposals to Reform Domestic Insurance Policy"

May 20, 2014

Chairman Neugebauer, Ranking Member Capuano, and members of the Subcommittee, thank you very much for this opportunity to discuss various proposed bills implicating the federal government's role in insurance regulation and monitoring. In my testimony, I will first explain my broad perspective on the appropriate role for the federal government in regulating and monitoring insurance markets. In doing so, I will emphasize that – as demonstrated by the 2008 financial crisis – the business of insurance can create important systemic risks to the larger financial system.[1] The specific contours and magnitudes of these systemic risks are constantly evolving based on shifts in the insurance industry and its regulation. For these reasons, consistent with the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), the federal government should maintain a robust

[1] *See generally* Daniel Schwarcz & Steven Schwarcz, *Regulating Systemic Risk in Insurance*, 81 U. CHICAGO LAW REVIEW (forthcoming, 2014), available at http://ssrn.com/abstract=2404492. For a more skeptical assessment of the possibility of systemic risk in insurance, see J. David Cummins & Mary A. Weiss, *Systemic Risk and the U.S. Insurance Sector* (2011), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1725512 and Scott Harrington, *The Financial Crisis, Systemic Risk, and the Future of Insurance Regulation*, 76 J. RISK & INS. 785 (2009).

presence in regulating potentially systemically risky insurance entities and activities and in monitoring the insurance market for potential new sources of systemic risk.

After having reviewed these broad themes, my testimony will address elements of some of the proposed bills that I believe unwisely interfere with the federal government's ability to appropriately regulate and monitor the insurance industry. A common theme in the provisions that I identify is that they unduly limit the ability of federal agencies to regulate, identify, or respond to new and emerging sources of systemic risk in insurance markets. Given the importance of insurers to the 2008 financial crisis and the potential for insurers to pose various new types of systemic risks in the future, imposing excessive restrictions on federal agencies charged with regulating or monitoring systemic risk in insurance is unwise.

(1) Systemic Risk in Insurance

As exemplified by the dramatic failures of American International Group ("AIG") and various financial guarantee insurers, as well as the temporary but severe capital shortfalls of large life insurance companies that had issued long-term guarantees to policyholders, insurance companies and their affiliates played a central role in the 2008 financial crisis. It is now generally accepted that insurers and their affiliates that effectively provide insurance against the default of financial instruments – whether through formal insurance policies (as in the case of financial guarantee insurers) or through derivatives such as credit default swaps (as in the case of AIG) – can contribute to systemic risk. Other "non-traditional" insurance

activities, such as extensive use of securities lending (as in the case of AIG), can also prove systemically risky. [2]

But in the last several years, a narrative has emerged suggesting that these risks are vanishingly small. This argument emphasizes that very few traditional insurers actually failed during the financial crisis. It also stresses that AIG Financial Products – the division of AIG that was principally responsible for writing the credit default swaps that were an important source of the company's problems – was not regulated as an insurance company, in large part due to federal law. Finally, and perhaps most prominently, it argues that insurers, unlike banks, do not have a mismatch in their assets and liabilities that can make them susceptible to run-like dynamics.

This narrative, however, ignores important linkages between the insurance industry and the rest of the financial system as well as insurers' potential vulnerabilities to catastrophic events. Although the insurance industry is indeed less systemically risky than the banking and shadow banking sectors, it is also structurally capable of posing a variety of systemic risks to the larger financial system. Perhaps even more importantly, the magnitude and character of these risks are themselves constantly evolving and shifting. A decade ago, the notion that a company within an insurance group could threaten the global financial system through its portfolio of credit default swaps would have been viewed as preposterous. The lesson is that the regulation of systemic risk in insurance must

[2] A substantial contributor to AIG's woes was its securities lending program, which, while coordinated by a non-insurer affiliate of AIG, exploited securities owned by AIG's insurers. *See* William K. Sjostrom, Jr, *The AIG Bailout*, 66 WASH. & LEE L. Rev. 943 (2009).

be designed to allow regulators and monitors to proactively identify, assess, and manage new potential sources of risk. With this in mind, consider several specific ways in which insurers could potentially threaten the stability of the broader financial system.

Asset Fire Sales: Insurers are among the largest and most important institutional investors domestically and internationally. They own approximately one-third of all investment-grade bonds and, collectively, own almost twice as much in foreign, corporate, and municipal bonds than do banks. Insurers' massive role as investors means that they can pose systemic risks by triggering or exacerbating "fire sales" of specific securities or types of securities. Emerging evidence suggests that a subset of insurers did stoke fire sales in mortgage-backed securities and related instruments in 2008, when they attempted to sell these securities in response to regulatory, rating agency, and market pressures.[3] Insurers' capacity to trigger fire sales is likely much stronger in corporate bond markets, where insurers are the dominant investors among all financial institutions. Thus, one recent study found compelling evidence that the downgrading of corporate bonds can prompt large numbers of insurers to sell the downgraded (or about-to-be downgraded) bonds in

[3] Craig B. Merrill, Taylor D. Nadauld, Rene M. Stulz, & Shane Sherlund, *Did Capital Requirements and Fair Value Accounting Spark Fire Sales in Distressed Mortgage-Backed Securities?*, NBER Working Paper No. 18270 (Aug. 2012), *available at* http://www.nber.org/papers/w18270; Andrew Ellul, Pab Jotikasthira, Christian T. Lundblad, Yihui Wang et al., *Is Historical Cost Accounting a Panacea? Market Stress, Incentives Distortions, and Gains Trading* (NYU Working Paper, 2012), *available at* http://ssrn.com/abstract=1972027.

a coordinated fashion, causing the price of the downgraded bonds to temporarily fall below their fundamental value.[4]

Credit Crunches: Apart from the risk of fire sales, disruptions in insurance markets could substantially impact corporate financing. Corporations fund themselves much more through debt than equity, and insurers are a central purchaser of corporate debt. If insurers were forced to liquidate a substantial percentage of their holdings and were unable to maintain their long-sustained investment appetite for corporate debt, the results could be catastrophic. U.S. corporations would have to either dramatically scale back their activities or find entirely new ways of funding their operations. This, in turn, could trigger new, and unpredictable, consequences in volatile financial markets.

Demand for Assets that Spread Systemic Risk: Financial markets, as with all markets, are impacted both by supply-side forces and demand-side forces. When insurers collectively demand certain types of financial assets, the amount supplied and prices of these assets will increase. In fact, recent evidence shows the insurance industry played a major role in increasing demand for mortgage-backed securities and related instruments in the years leading up to the financial crisis.[5] Recent evidence also shows that insurers' investments in corporate debt markets can

[4] Andrew Ellul, Chotibhak Jotikasthira, & Christian T. Lundblad, *Regulatory Pressure and Fire Sales in the Corporate Bond Market*, 101 J. FINANCIAL ECON. 596 (2011).
[5] Craig Merrill, Taylor D. Nadauld, & Philip Strahan, *Final Demand for Structured Finance Securities*, (Working Paper, January 17, 2014) *available at* http://ssrn.com/abstract=2380859.

produce capital market distortions that can directly amplify systemic risk by contributing to pro-cyclical build-ups in the holding of high-yield, risky assets.[6]

Simultaneous Failure of Several Large Insurers: Although insurers need not fail in order to contribute to systemic risk, the converse is not true: substantial failures of several large insurers could well disrupt the financial system as a result of insurers' status as massive investors. The failure of several large insurers is hardly unimaginable. Insurers are potentially subject to a wide array of catastrophe risks that could trigger a wave of claims across numerous insurers within a short time frame. Insurers also frequently adopt similar investment strategies in response to common product designs and regulatory pressures.

Interconnectedness through Reinsurance: Although insurers attempt to manage catastrophe risk through reinsurance arrangements, the reinsurance industry itself is potentially subject to catastrophe risk. The reinsurance industry is extremely concentrated in a few massive firms, such as Swiss Re, Munich Re, and Berkshire Hathaway. In 2009, for instance, five reinsurance groups provided approximately 60% of the world's reinsurance capacity.[7] This concentration creates deep interconnections among insurers, such that the failure of one or two major reinsurers could simultaneously impact a substantial segment of the insurance industry at once. This risk is exacerbated by the fact that reinsurer financial strength is itself highly opaque, and reinsurers often reinsure risks with one another,

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[6] See Bo Becker, & Victoria Ivashina, *Reaching for Yield in the Bond Market*, JOURNAL OF FINANCE (forthcoming), *available at* http://www.hbs.edu/faculty/Publication%20Files/12-103_c2425c59-1647-42df-8d1b-7b8ed433fb76.pdf.

[7] INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS, REINSURANCE AND FINANCIAL STABILITY (July 2012).

creating the possibility that one reinsurer's failure could have a domino effect on other reinsurers.[8]

Exposure to Policyholder Runs: Despite their frequent protestations to the contrary, life insurers are also not immune to the possibility of a run on their products. This is because many life insurance products allow policyholders to withdraw funds or receive a significant cash surrender value.[9] Various market dynamics may lead to insurance policies in the future with more generous withdrawal or cash-surrender benefits. Meanwhile, other trends, such as insurers' embrace of "retained asset accounts" that function almost identically to bank accounts, can also increase the prospect that the long-term nature of insurers' liabilities may become short term in tail-end events. The risk of a policyholder run is exacerbated by the fact that state insurance guarantee funds do not generally fully guarantee the value of many insurance policies, cannot be spread among companies or policies to increase limits (unlike FDIC insurance), and are much less financially credible than FDIC insurance as they are not pre-funded or explicitly backstopped by the federal government.

Systematic Under-Reserving: There is a real risk that insurers may systematically underestimate reserves for certain types of policies or losses. Two

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[8] GROUP OF THIRTY, REINSURANCE AND INTERNATIONAL MARKETS (2006).

[9] *See* FSOC, BASIS FOR THE FINANCIAL STABILITY OVERSIGHT COUNCIL'S FINAL DETERMINATION REGARDING PRUDENTIAL FINANCIAL INC. (Sept. 19, 2013). The most substantial policyholder run on a U.S. insurance company involved Executive Life, where policyholder cash surrenders exceeded over $3 billion in the year prior to its failure. Although this run was more a product of Executive Life's tenuous financial position than the cause of its tenuous position, it did indeed have the effect of forcing Executive Life to liquidate a substantial percentage of its portfolio. *See* Scott Harrington, *Policyholder Runs, Life Insurance Company Failures, and Insurance Solvency Regulation*, 15 REGULATION 27 (1992).

recent, and related, developments contribute to this risk. First, in the last decade or so, life insurers have increasingly used captive insurance companies to escape regulatory rules governing reserve setting, a process that some have referred to as "shadow insurance."[10] Recent estimates conclude that "shadow insurance reduces risk-based capital by 53 percentage points (or 3 rating notches) and raises impairment probabilities by a factor of four."[11] Second, state insurance regulation is currently embarking on a fundamental change to its regulatory approach, which would grant insurers broad discretion to use internal models to set reserve levels. The extensively documented inability of federal regulators to fully understand financial firms' internal risk models suggests that large-scale errors in life insurer reserving could be a problem in the future. This is particularly so given that state regulators currently lack sufficient technical expertise or resources to undertake a reasonable evaluation of these models on a firm-by-firm basis.[12]

(2) Federal Role in Insurance Regulation and Monitoring

Ultimately, it is surely true that the insurance industry currently poses less systemic risk than the banking sector or the shadow-banking sector. At the same time, however, the insurance industry is a crucial and dynamic component of the American and international financial systems, a fact that has been documented by various studies quantifying the connections between insurers and the rest of the

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[10] *See* NY DEPARTMENT OF FINANCIAL SERVICES, SHINING A LIGHT ON SHADOW INSURANCE (June 2013).
[11] *See* Ralph S.J. Koijen and Motohiro Yogo, *Shadow Insurance* (NBER Working Paper No. 19568, (2013), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2320921.
[12] FEDERAL INSURANCE OFFICE, HOW TO MODERNIZE AND IMPROVE THE SYSTEM OF INSURANCE REGULATION IN THE UNITED STATES, (December 2013).

financial system based on historical stock prices and similar metrics.[13] As such, the insurance industry can indeed present a meaningful source of systemic risk that cannot be easily limited to a pre-defined set of activities.

For all of these reasons, and as contemplated by Dodd-Frank, federal regulators should play a robust role in regulating potential systemic risk in insurance and in monitoring insurance markets for potential new sources of systemic risk. A central tenet of federalism is that regulatory responsibilities should be assigned, at least in part, to the unit of government that best internalizes the full costs of the underlying regulated activity.[14] The rationale for this principle is that government entities will only have optimal incentives to take into account the full costs and benefits of their regulatory decisions if the impacts of those decisions are felt entirely within their jurisdictions. Given that systemic risk in insurance is a negative externality whose effects are inherently felt nationally and internationally, national and international regulatory bodies should play a role in regulating systemically significant insurers.

Federal regulation and monitoring of systemic risk in insurance is particularly important because state insurance regulation is focused predominantly on policyholder protection rather than systemic stability. These differing regulatory perspectives can have important implications for a range of regulatory issues.

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[13] Monica Billioa, Mila Getmanskyb, Andrew W. Loc, & Loriana Pelizzona, *Econometric Measures of Connectedness and Systemic Risk in the Finance and Insurance Sectors* 104 J FIN. ECON. 535 (2012); Faisal Balucha, Stanley Mutengab & Chris Parsons Baluch, *Insurance, Systemic Risk and the Financial Crisis*, 36 THE GENEVA PAPERS 126 (2011); Viral Acharya, Lasse Heje Pedersen, Thomas Philippon, & Matthew P. Richardson, *Measuring Systemic Risk* (2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1573171.

[14] WALLACE E. OATES, FISCAL FEDERALISM (1972).

Consider one example: the regulation of financial guarantee insurers. Because state insurance regulators focus predominantly on policyholder protection, their central approach to regulating financial guarantee insurance prior to the crisis was to insist that such insurance be provided only by "monoline" companies, which would write only financial guarantee insurance. This approach shielded most ordinary policyholders from the potential implications of financial guarantee insurers' massive losses in connection with the financial crisis. From a policyholder protection perspective, then, this regulatory strategy was largely successful. However, from a systemic risk perspective this regulatory approach was woefully incomplete: merely segmenting financial guarantee insurance from other insurance policy lines did nothing to prevent financial guarantee insurers from insuring against the default of risky mortgage-backed securities in a way that exposed them to massive correlated risks that reverberated throughout the larger financial system.

(3) Proposed Bills Implicating the Federal Government's Role in Insurance Regulation and Monitoring

Contrary to the broad approach suggested above, several portions of the proposed bills excessively restrict the capacity of federal entities to effectively identify, regulate, and respond to systemic risk in insurance.

HR 4510: I support HR 4510's clarification of the Federal Reserve's (Fed) authority to tailor capital rules to meet the particular risks of insurance companies. As I have previously testified to the Senate Subcommittee on Financial Institutions and Consumer Protection, insurers do indeed present unique risks that differ from

those of banks. Mechanistically applying bank capital rules to insurers would be poor public policy. At the same time, capital rules for federally-regulated insurance companies or companies predominantly engaged in insurance should not simply replicate state risk-based capital rules, which focus primarily on policyholder protection. Instead, they should be tailored to meet the distinct federal interests associated with preventing systemic risk in insurance. As I understand HR 4510, it would preserve the Fed's ability to devise capital rules that accomplish this.

Nonetheless, I am concerned that one provision in HR 4510 would unnecessarily curtail the capacity of the Fed to demand important information from insurers whose financial statements are currently prepared using only Statutory Accounting Principles (SAP). SAP is not just an accounting system: it is premised on numerous state regulatory determinations. By forcing the Fed to work only with data produced pursuant to SAP, the bill would undermine the Fed's ability to regulate insurers for systemic risk concerns.

One important example of this point is that SAP is inherently focused on individual insurance entities, rather than entire holding companies. Under SAP, it is extremely difficult for regulators to get an accurate sense of the overall financial health of a holding company. Although SAP's entity-centric approach tends to work well in addressing policyholder protection concerns, it is substantially incomplete from a systemic risk orientation. Group-wide assessments of financial health are essential for systemic risk regulation because risk-management, investment strategies and business priorities are all generally determined at the holding

company level. Group solvency regulation can also limit the prospect of other problems that may have systemic consequences, such as double or multiple gearing or correlations in risk exposures across companies within a holding company structure.

Categorically preventing the Fed from demanding information outside of the SAP framework also severely inhibits the agency's ability to proactively identify and respond to new or emerging potential sources of systemic risk in insurance. As emphasized above, systemic risk in insurance is not static because the insurance industry and state regulation are constantly changing. If the Fed is to perform its statutorily mandated role, it must be able to adapt to these changing circumstances by demanding appropriate information in a form that will transparently reflect the regulated entity's true financial condition.

To take one potential, but I believe increasingly important, example, SAP incorporates state rules on reserving for policy liabilities. Such reserves are the central liabilities on insurers' balance sheets. However, as discussed above, recent evidence shows that life insurers are increasingly exploiting captive insurance companies to escape these regulatory rules. Meanwhile, state insurance regulation is moving to a system that would grant life insurers broad discretion to use internal models to set reserve levels. In order for federal regulators to monitor these developments for systemic risks, they must be able to demand financial information in forms that may depart from SAP.

In making these points, I am aware of the legitimate concerns of impacted insurance carriers, which might well be forced to incur expenses to prepare financial data in a form that differs from SAP. These concerns, however, may be exaggerated because Dodd-Frank already requires that the Fed shall to "the fullest extent possible use information that is obtainable from federal or state regulatory agencies." This existing safeguard limits the prospect that the Fed could demand information from insurers that it could acquire elsewhere. Additionally, instead of requiring, for instance, that the Fed should explore alternatives to GAAP reporting that might provide sufficient information for regulatory purposes while imposing reduced costs on regulated companies that otherwise report exclusively using SAP, the proposed language has the apparent effect of prohibiting the Fed from requiring any information from certain regulated entities that is inconsistent with SAP.

By limiting the capacity of the Fed to insist on financial information that may not be fully transparent or available in SAP, the provision undermines the Fed's capacity to regulate insurance companies that may pose systemic risks. It is impossible to foresee every possible risk that might lead the Fed to ask for information in a form that deviates from SAP. Effective systemic risk supervision requires adaptive regulation that is responsive to new and emerging potential risks. The proposed SAP mandate in HR 4510 undermines the Fed's ability to engage in such supervision.

Data Protection Act: As above, I believe that the proposed Data Protection Act is unwise public policy because it could unduly inhibit the ability of FIO and OFR to

identify potential or emerging sources of systemic risk in insurance.[15] This is a crucial supplement to the Fed's insurance-regulatory role: the Fed's authority extends only to a small subset of insurers and insurance-focused companies, but systemic risk in insurance can arise outside of individual large insurance companies due to correlations among insurance carriers' practices or risk exposures.[16]

In order to appropriately monitor the insurance industry for new or emerging sources of systemic risk, both FIO and OFR may well need information that is neither publicly available nor currently accessible from other agencies. The reason is simple: by their very nature, new or emerging sources of systemic risk may not be fully reflected in preexisting documentation or data. To be sure, this is likely to be rare, especially given the extensive nature of the financial data that state regulators currently collect. Indeed, FIO has not actually used its subpoena power to date.

This infrequency of insurance-focused data requests makes all the more bizarre the bill's provision requiring the Secretary of the Treasury (Secretary) to reimburse insurers for the costs of complying with FIO or OFR subpoenas. The costs of monitoring for potentially systemically risk activities are a classic negative externality: they are a social cost that results from private behavior. As with all negative externalities, these social costs should be borne by the responsible industry. The reimbursement provisions of 12 CFR 219, which are referenced in the

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[15] Dodd-Frank charges FIO with several additional important roles, including assessing the availability and affordability of insurance for traditionally underserved communities and consumers.
[16] Daniel Schwarcz & Steven Schwarcz, *Regulating Systemic Risk in Insurance*, 81 U. CHICAGO LAW REVIEW (forthcoming, 2014), available at http://ssrn.com/abstract=2404492.

bill, apply to an entirely different, and quite narrow, set of information requests, which target customer financial records rather than information pertaining to risks within a broad market.

Reversing this universal and commonsense presumption that industry must bear the costs of complying with government information demands would excessively chill systemic risk monitoring in insurance. First, it is very hard to envision how the Secretary could budget for the expenditures that would be associated with the issuing of subpoenas to insurers under the proposed bill. Consequently, the Secretary could be put in the position of unexpectedly cutting back on important departmental functions in order to acquire important information from private insurance companies. Second, requiring potentially substantial government expenditures whenever FIO or OFR issues a subpoena would unduly politicize the exercise of this authority.

HR 605: This bill would, in my view, unwisely remove entirely insurance companies from Dodd-Frank's OLA process. Dodd-Frank was drafted so that insurance companies are already largely excluded from the OLA regime. Under Dodd-Frank, insurance companies must be resolved in state courts pursuant to state law even if they are a "covered financial company," meaning that a determination has been made by relevant federal authorities that the insurer is in default or in danger of default and its failure could pose broad systemic risks to the larger financial system. Moreover, as under ordinary insurance law, state insurance regulators would generally be in charge of initiating the resolution process. The

only exception is if a state insurance regulator refused to initiate resolution proceedings notwithstanding a federal determination that such a proceeding was necessary to safeguard the country's financial stability. In that event, the FDIC would be authorized to "stand in the place" of the state regulator to resolve the insurance company.

This framework represents a sensible balancing of state and federal interests with respect to the resolution of systemically significant insurance companies. Notwithstanding the FDIC's "backup authority," these provisions virtually guarantee that the appropriate state insurance regulator, rather than the FDIC, would conduct proceedings to resolve systemically significant insurance companies. It is hard to imagine that the appropriate state insurance regulator would refuse to initiate resolution proceedings for an insurer in the event that federal authorities had determined that its failure could produce systemic consequences. But it is even harder to imagine that the state insurance regulator would fail to initiate such proceedings knowing that the FDIC could do so in its place. The primary utility of the backup authority, then, is to encourage otherwise reluctant state regulators to resolve failing insurance companies when federal interests so require. In the exceedingly unlikely scenario that a state insurance regulator nonetheless refused to initiate resolution proceedings, the intervention of the FDIC would be appropriate. As described above, federal regulators generally have better incentives and knowledge than state regulators when it comes to managing systemic risk.

Risk Retention Modernization Act of 2014: Unlike each of the other bills addressed above, the proposed Risk Retention Modernization Act of 2014 does not implicate systemic risk issues. Instead, this proposed bill raises certain consumer protection concerns. The bill would expand the authority of Risk Retention Groups (RRGs) to offer commercial property insurance, in addition to commercial liability insurance. Historically, RRGs have played an important role in commercial liability insurance markets, which can be subject to extreme "hard markets" in which coverage is either completely unavailable or excessively expensive. Commercial property markets, however, generally experience only relatively mild underwriting cycles. The reason is that property insurance generally is provided only on an annual basis, in contrast to many types of liability insurance, which provide "long-tail" coverage. Long tail lines of coverage are susceptible to extreme underwriting cycles because of the inherent difficulty of setting premiums based on costs that may be incurred far into the future. Because commercial property insurance markets do not experience severe hard markets, there is much less of a need for the RRG structure in these markets than there is in commercial liability insurance markets.

Moreover, RRGs raise clear policyholder protection concerns. RRGs do not provide policyholders with the protection of state guarantee funds. Moreover, the essential structure of these entities – which are regulated only in a single state, but can operate nationally – can result in a "race to the bottom," where states compete to attract RRGs by offering reduced regulatory oversight. To be sure, these risks are more limited in commercial markets than in personal lines markets, because

policyholders are comparatively more sophisticated. Moreover, the fact policyholders own RRGs also provides a countermeasure against the risk of inadequate policyholder protection. Nonetheless, these safeguards are hardly foolproof: many policyholders in commercial lines are relatively unsophisticated about insurance, and member-ownership of RRGs does not preclude the risk of substantial governance problems.

Weighing the potentially significant policyholder protection costs of expanding RRGs against the limited benefits that such an expansion could provide, my view is that the proposed Risk Retention Modernization Act of 2014 is bad public policy.

ACLI
Financial Security...for Life.

May 20, 2014

Congressman Randy Neugebauer, Chairman
Subcommittee on Housing and Insurance
Committee on Financial Services
U.S. House of Representatives
2129 Rayburn House Office Building

Dear Chairman Neugebauer:

We are writing to express our support for S. 2270/H.R. 4510, legislation that would clarify the Federal Reserve Board's (Fed) authority to apply insurance-based capital standards to insurance companies subject to Fed supervision. As you know, there is broad consensus among policymakers, regulators, and industry experts that insurance is very different from banking and should be regulated in a way that reflects those differences.

Only insurance-based standards are suitable for assessing and safeguarding the capital strength of insurance companies. The Fed should have the authority to design consolidated insurance capital standards that are appropriate for the insurance business model and serve the goals of prudential supervision. We urge you to co-sponsor and pass S. 2270/H.R. 4510 as soon as possible.

Life insurers offer long-term products and services such as life insurance, annuities, retirement plans, long-term care and disability income insurance, and reinsurance, providing financial and retirement security to 75 million American families. The industry pays out $1.5 billion every day to families and businesses, and is a cornerstone of the U.S. economy, generating 2.5 million jobs and investing $5.2 trillion to support economic expansion.

In order to provide these products that support long-term savings and financial security for our customers, our capital standards must be appropriately regulated. Without action by Congress, a significant portion of the life insurance industry would be subject to capital standards that are specifically designed for other businesses and disconnected from the risks specific to life insurers. Applying inappropriate capital standards would make it substantially harder for our companies to deliver on the promises we have made to our policyholders. We believe that the interests of insurance regulators, insurance markets, and insurance customers are best served by capital standards specifically designed for the insurance business model.

We hope you will consider co-sponsoring S. 2270/H.R. 4510 and supporting swift passage of this legislation. We look forward to working with you on this issue which is of critical importance to our industry and our customers.

Sincerely,

Dirk Kempthorne
President and CEO
American Council of Life Insurers

Jay S. Wintrob
President and CEO
AIG Life and Retirement

Walter White
President and CEO
Allianz Life of North America

Don Civgin
President and CEO
Allstate Financial

John Matovina
President and CEO
American Equity Investment Life Holding Company

Todd Fancher
President
American Family Life Insurance Company

David R. Carpenter
President
American Fidelity Assurance Company

JoAnn M. Martin
Chair, President and CEO
Ameritas Life Insurance Corporation

Thomas E. Henning
Chairman, President and CEO
Assurity Life Insurance Company

Eugene Choate
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Bankers Fidelity Life Insurance Company

Paul A. Quaranto, Jr.
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Boston Mutual Life Insurance Company

Edward J. Bonach
CEO
CNO Financial Group

Kurt F. Bock
CEO
COUNTRY Life Insurance Company

Jim Brannen
CEO
FBL Financial Group, Inc.

Thomas J. McInerney
President and CEO
Genworth Financial

Deanna Mulligan
President and CEO
The Guardian Life Insurance Company of America

Peter R. Schaefer
President and CEO
Hannover Life Reassurance Company of America

Craig Bromley
President
John Hancock

Donald G. Southwell
Chairman, President and CEO
Kemper Corporation

James D. Atkins
President and CEO
Legal and General America

Dennis Glass
President and CEO
Lincoln Financial Group

Roger W. Crandall
Chairman, President & CEO
MassMutual

Timothy Hall
President and CEO
Medico Insurance Company

William J. Wheeler
President, The Americas
MetLife

W. Kenny Massey
President and CEO
Modern Woodmen of America

David L. Kaufman
CEO
Motorists Life Insurance Company

Stephen M. Batza
President and CEO
MTL Insurance Company

Daniel P. Neary
Chairman and CEO
Mutual of Omaha Insurance Company

Kirt Walker
President and COO
Nationwide Financial

Ted Mathas
Chairman, President and CEO
New York Life Insurance Company

John E. Schlifske
Chairman and CEO
Northwestern Mutual

Gary T. Huffman
Chairman, President and CEO
Ohio National Financial Services

J. Scott Davison
Chairman and CEO
OneAmerica Financial Partners

Mark A. Haydukovich
President and CEO
Oxford Life Insurance Company

James T. Morris
Chairman and CEO
Pacific Life Insurance Company

Eileen C. McDonnell
Chairman, President and CEO
Penn Mutual

Larry Zimpleman
Chairman, President and CEO
Principal Financial Group

John D. Johns
Chairman, President and CEO
Protective Life Corporation

John Strangfeld
Chairman and CEO
Prudential Financial, Inc.

Lawrence E. Daurelle
President and CEO
Reliance Standard Life Insurance Company

John Woerner
President, Insurance & Annuities and CSO
RiverSource Insurance

Bart F. Catmull
President
Sagicor Life Insurance Company

Esfandyar Dinshaw
Chairman and CEO
Sammons Financial Group

Bruce W. Boyea
Chairman, President and CEO
Security Mutual Life Insurance Company of NY

Joe Monk
Senior Vice President and CAO
State Farm Life Company

Eric Smith
President and CEO
Swiss Re Americas

Tom Marra
President and CEO
Symetra

Brad L. Hewitt
President and CEO
Thrivent Financial

Roger W. Ferguson, Jr.
President and CEO
TIAA-CREF

Mark Mullin
President and CEO
Transamerica

Brandon Carter
President
USAA Life Insurance Company

Rodney O. Martin, Jr.
Chairman and CEO
Voya Financial, Inc.

John F. Barrett
Chairman, President and CEO
Western and Southern Financial Group

Larry R. King
Chairman, President and CEO
Woodmen of the World

Statement of the American Insurance Association

Before the

Committee on Financial Services

Subcommittee on Housing and Insurance

United States House of Representatives

"Legislative Proposals to Reform Domestic Insurance Policy"

May 20, 2014

Statement of the American Insurance Association

"Legislative Proposals to Reform Domestic Insurance Policy"

The American Insurance Association (AIA) appreciates the opportunity to submit comments to the Subcommittee on Housing and Insurance on proposed and pending legislation to reform domestic insurance policy. The proposals that are the subject of this hearing touch upon several important areas of insurance regulatory modernization, including legislation designed to aid implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) and proposed legislation that would expand the authority of risk retention groups.

AIA represents approximately 300 of the nation's leading insurance companies that provide all lines of property and casualty insurance to consumers and businesses in the United States and around the world. AIA members write more than $117 billion annually in U.S. property-casualty premiums and approximately $225 billion annually in worldwide property-casualty premiums.

Our members have a strong interest in ensuring that implementation of the Dodd-Frank Act carries out Congressional intent and aligns with the insurance business model and the regulatory system that flows from that model. At the same time, our members have an equally compelling stake in ensuring a level competitive playing field and accompanying regulatory oversight that does not favor one form of corporate organization over another and focuses on maintaining policyholder protection through appropriate financial standards. As set forth in more detail below, therefore, AIA supports the four legislative proposals that further consistent and careful implementation of the Dodd-Frank Act, but we would strongly caution against expansion of the authority of risk retention groups to offer additional commercial lines insurance, as proposed by the Risk Retention Modernization Act of 2014.

Dodd-Frank Act Implementation Proposals

This hearing focuses on four measures to smooth implementation of the Dodd-Frank Act with respect to the distinct treatment of insurance companies:

1. **H.R. 4510** (The Capital Standards Clarification Act of 2014), which clarifies the application of capital standards to insurance companies that are supervised by the Board of Governors of the Federal Reserve System (Federal Reserve Board or Board).
2. **H.R. 4557** (The Policyholder Protection Act of 2014), which preserves the ability of a state insurance regulator to protect policyholders and the financial solvency of an insurance company that is affiliated with a failing depository institution.
3. **H.R. 605** (The Insurance Consumer Protection and Solvency Act of 2013), which reaffirms the primacy of state liquidation and rehabilitation laws for insurance companies under Title II of the Dodd-Frank Act, and clarifies an insurance exemption from Title II's risk-based "orderly liquidation" assessments.
4. **H.R. __** (The Insurance Data Protection Act), which removes the authority of the Office of Financial Research (OFR) to subpoena insurance company data and places constraints on the subpoena authority of the Federal Insurance Office (FIO).

As AIA has consistently indicated in previous submissions to Congress and federal financial institution regulatory agencies, the Dodd-Frank Act differentiates in numerous places between insurance companies and banking organizations, most notably in the Title I and II provisions governing the cradle-to-grave designation, prudential supervision and orderly liquidation of insurance companies that might be considered systemically important themselves or part of more diverse bank or thrift holding companies or systemically important financial institutions (SIFIs). In addition, the Dodd-Frank Act devotes a separate title – Title V – to the establishment of the FIO and its enumerated functions, as well as the implementation of state-based reforms in the surplus lines and reinsurance industries. Finally, Title X of the Act broadly exempts the

"business of insurance" from the jurisdiction of the Bureau of Consumer Financial Protection (CFPB). Taken together, these provisions balance the need for national oversight of potential systemically risky activities with appropriate deference to existing state-based regulation of the insurance business. These distinctions must be respected and maintained in regulations that are adopted in accordance with the Act.

H.R. 4510 and H.R. 4557

With respect to H.R. 4510, as with the companion Senate bill (S. 2270), AIA supports efforts to confirm the ability of the Board to develop capital rules that are appropriately tailored to insurance companies that are subject to Federal Reserve Board supervision. Likewise, AIA welcomes H.R. 4557, which is designed to reinforce the ability of state insurance regulators to protect policyholders and the financial solvency of the insurance companies in their respective jurisdictions by requiring insurance regulatory approval before capital is siphoned away from those companies.

We are heartened by statements of Chair Yellen during recent testimony and Federal Reserve Board actions in establishing enhanced prudential standards for certain bank holding companies and foreign banking organizations. These statements and actions indicate the Board's recognition that insurers are different than banks, and measures and requirements applicable to banking organizations cannot be mechanistically applied to insurers and companies that control insurers.

Insurance regulation emphasizes policyholder protection and the ability to provide capital to meet insurance consumer demand. As a general matter, therefore, capital is maintained at the operating company level so that it can be deployed to cover insured losses. In the U.S., capital is not generally maintained at the holding company level to serve as a source of strength to the operating companies. U.S. financial regulatory standards and resolution mechanisms for insurers support this objective. Equally important, while some sections of the Dodd-Frank Act

grant the Board prudential supervisory authority over certain entities that engage in the business of insurance, nothing in the Act was intended to change the fundamental nature of insurance regulation. Both H.R. 4510 and H.R. 4557 capture the spirit of that intent.

Section 165 of the Dodd-Frank Act provides additional evidence of Congress' intent to distinguish depository institutions from insurance companies. As the Subcommittee knows, Section 165 directs the Federal Reserve Board to establish prudential standards for bank holding companies with total consolidated assets of $50 billion or more, and for nonbank financial companies that the Financial Stability Oversight Council (FSOC or Council) has designated for supervision by the Board, in order to prevent or mitigate risks to U.S. financial stability that could arise from the material financial distress or failure, or ongoing activities of, large, interconnected financial institutions. The Federal Reserve Board has stated that it possesses authority under Section 165 to apply the standards it establishes in a manner that differentiates among companies on an individual basis, or by category. Accordingly, the Board applied its final rules relating to enhanced supervision and regulation of covered companies in a manner that takes into account differences and risk characteristics among covered companies based on these factors.

However, the Board determined not to impose its enhanced prudential standards on nonbank financial companies supervised by the Board. Rather, the Board stated its intent to separately issue orders or rules imposing standards on each nonbank financial company subject to its supervision. For those nonbank financial companies that are similar in activities and risk profile to bank holding companies, the Board expects to apply enhanced prudential standards that are similar to those that apply to bank holding companies. For those that differ from bank holding companies in their activities, balance sheet structure, risk profile, and functional regulation, the Board stated that it expects to apply more tailored standards, after providing prior notice to affected companies and opportunity to comment. AIA supports the Board's actions to address the unique nature of nonbank financial companies subject to its supervision, and we look forward to the opportunity to comment on its standards when they are proposed.

At the same time, AIA is concerned that the language of Section 171 of the Dodd-Frank Act, commonly referred to as the "Collins Amendment," may be interpreted to undermine the Board's conclusion that one size cannot fit all. As the Subcommittee is aware, Section 171 requires the federal banking agencies to establish minimum leverage and risk-based capital requirements on a consolidated basis for insured depository institutions, depository institution holding companies (i.e., bank and savings and loan holding companies) and nonbank financial institutions supervised by the Board. The minimum requirements cannot be lower than the requirements in effect for depository institutions as of the date of enactment of the Dodd-Frank Act. The Board has stated that it is constrained by the language of Section 171 and does not have flexibility to take into account differences among financial institutions when it implements the requirements of that section. The inability of the Board under Section 171 to tailor the leverage and risk-based capital requirements will have the effect of undermining its recent actions taken under Section 165. Clearly, that was not the intent of Congress. Accordingly, we urge Congress to provide the Board with the authority needed to reflect the objectives Congress established for the Dodd-Frank Act. To that end, we reiterate our support for H.R. 4510. That legislation would clarify the Board's ability to tailor appropriate insurance-based capital standards for the insurance companies under its supervision. Further, AIA supports H.R. 4557, as it underscores the important policyholder protection role played by state insurance regulators when faced with efforts to draw capital away from operating insurance companies to fund a deficiency outside the regulated insurance companies.

H.R. 605

AIA also supports H.R. 605. Title II of the Dodd-Frank Act establishes a procedure for the appointment of the FDIC as receiver of a failing financial company that poses significant risk to the financial stability of the United States. Under this procedure, certain designated federal agencies would recommend to the Secretary of the Treasury (the "Secretary") that the Secretary, after consultation with the President, make a determination that grounds exist to appoint the FDIC as receiver of the company. The Federal Reserve Board and the Director of

the FIO will make the recommendation if the company or its largest subsidiary is an insurance company.[1] The process is similar to that which is applied to systemic risk determinations under section 13 of the Federal Deposit Insurance Act.[2]

Recommendations to the Secretary are to include an evaluation of whether the covered financial company is in default or in danger of default, a description of the effect that the company's default would have on the financial stability of the United States, and an evaluation of why a case under the Bankruptcy Code would not be appropriate.[3] In determining whether the FDIC should be appointed as receiver, the Secretary must make specific findings in support, including that: (a) the company is in default or in danger of default; (b) the failure of the company and its resolution under otherwise applicable federal or state law would have serious adverse effects on financial stability in the United States; (c) no viable private sector alternative is available; (d) any effect on the claims or interests of creditors, counterparties, and shareholders is appropriate; and (e) any action under the liquidation authority will avoid or mitigate such adverse effects taking into consideration the effectiveness of the action in mitigating the potential adverse effects on the financial system, cost to the general fund of the Treasury, and the potential to increase excessive risk-taking.[4] If the Secretary makes the recommended determination and the board of directors (or similar governing body) of the company acquiesces or consents to the appointment, then the FDIC's appointment as receiver is effective immediately. Judicial review is available in the event the company's board objects to the appointment.[5]

AIA believes that the low risk profile of property-casualty insurers engaged in traditional insurance activities effectively makes certain that such insurers will not pose a systemic threat

[1] Dodd-Frank Act, § 203(a)(1)(C). *See also* Dodd-Frank Act, § 502(a)(3) (adding 31 U.S.C. § 313(c)(1)(C)).
[2] 12 U.S.C. § 1823(c)(4).
[3] Dodd-Frank Act, § 203(a)(2).
[4] Dodd-Frank Act, § 203(b).
[5] Dodd-Frank Act, § 202(a)(1)(A)(i).

to U.S. financial stability.[6] As a result, AIA is of the view that the chances are quite remote that a property-casualty insurer would ever be designated a covered financial company under section 203(b).

Nonetheless, in order to deal with the uniqueness of the insurance industry, the Dodd-Frank Act has separate provisions that address the treatment of insurance companies under Title II's orderly liquidation process. If a covered financial company is an insurance company, or if an insurance company is a subsidiary or an affiliate of a covered financial company, liquidation of the insurance company is to be conducted in accordance with applicable state law.[7] The FDIC may step in to file an action in state court to place the company into liquidation only in the event that the appropriate state authority fails to initiate the required judicial action within 60 days of the determination. If the state authority files with the state court to place the company into liquidation, a receiver for the company will be appointed and its liquidation will proceed in accordance with state law. There is nothing in section 203(e) or in the available legislative history of the Dodd-Frank Act to suggest that in the event the FDIC makes the required filing in state court, the court must appoint the FDIC as receiver. Absent such an appointment, the FDIC has no jurisdiction over the liquidation of the company in receivership and, if appointed, the FDIC must conduct the liquidation process under state law. During the rulemaking process, there was some ambiguity regarding the extent of the FDIC's authority and when it was triggered. As a result, AIA welcomes H.R. 605, which will clarify these issues and provide an appropriate exemption for insurers from the "orderly liquidation" risk-based assessment process.

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[6] *See Comments of the American Insurance Association in Response to Advance Notice of Proposed Rulemaking Regarding Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies (and related attachments)*, Docket ID No. FSOC-2010-0001-0029, 0029.1, 0029.2 & 0029.3 (Nov. 5, 2010), for a more detailed explanation of this position.

[7] Dodd-Frank Act § 203(e).

The Insurance Data Protection Act

Finally, the Subcommittee will consider a legislative proposal, the Insurance Data Protection Act, which would eliminate the authority of the Office of Financial Research (OFR) to subpoena data or information directly from an insurance company, and instead would channel requests through the appropriate state insurance regulator, federal agency, or public source. The proposal would also place restrictions on FIO's subpoena authority as well. AIA believes that this legislative change is consistent with the intent underlying the data collection function of the FIO under Title V and clarifies potentially competing authority of the OFR and the FIO. Indeed, Title V contains language that is meant to protect the confidentiality and privileges that attach to non-public data, and to ensure that the FIO is required to go to available sources of information, rather than imposing additional data reporting burdens on insurers in the first instance.

AIA believes that the limitations on subpoena authority are particularly germane to the OFR, as this authority could cloud the primary functions of the FIO and result in overlapping and inconsistent federal roles. There is little doubt that Title V was not intended to create confusion as to whether the OFR or FIO governed federal data collection for insurers. Therefore, we appreciate the restrictions and limitations set forth in the Insurance Data Protection Act.

Risk Retention Modernization Act of 2014

Lastly, AIA has reviewed the legislative proposal for the Risk Retention Modernization Act of 2014 that would expand commercial lines writing authority for risk retention groups. Currently, risk retention groups are permitted to write only commercial liability insurance (with the exception of workers compensation), but under the present proposal, they would be authorized to write additional commercial lines—most notably commercial property insurance coverage.

AIA cannot support this proposal, and would caution against expansion of risk retention group authority at this time.

We recognize that risk retention groups have had a steady, small role in the commercial liability insurance market for more than 25 years, but an expansion to include commercial property insurance presents solvency and capacity challenges that should be taken into account and further explored before an expansion is considered.

It cannot be disregarded that risk retention groups have less rigorous solvency oversight than traditional insurers, which are subject to such regulation in every state where they do business, not just in their domiciliary state. Congress, no doubt recognizing that risk retention groups are subject to less stringent solvency regulation, excluded them from state insurance guaranty funds. Certainly, therefore, concerns about the adequacy of the regulatory environment should be appropriately addressed before any expansion of commercial writing by risk retention groups is considered.

In addition, risk retention groups are relatively small financial entities. In 2000, the largest groups had premiums of about $50 million - equivalent to the 350th largest property-casualty insurance company. These numbers, although bound to change from year to year, at the very least generate questions over whether the risk retention groups have the capacity to respond to the scale of insured losses associated with a catastrophic event, such as a major terrorist attack or hurricane. Further, with respect to terrorism risk, almost every study has concluded that the amount of available terrorism reinsurance is approximately $6 – 10 billion (and virtually none is available to address unconventional types of terrorism such as nuclear, biological, chemical or radiological attacks). Yet, risk retention groups generally rely on the same reinsurers as commercial insurance companies to spread their risk, particularly given their relatively small size. Absent available reinsurance, risk retention groups would not be capable of prudently managing their members' risk that comes with expanded commercial lines

capability. If they failed in a terrorist or natural catastrophe, there would be inevitable pressure for Congress to cover the losses.

Finally, this proposal, when considered against the backdrop of the other proposals under review, seems to depart from a direction that enhances financial solvency and reinforces the principal regulatory goal of policyholder protection consistent with the insurance business model. For all of these reasons, we cannot support the proposal.

Conclusion

We thank the Subcommittee for holding this hearing to better understand the five proposals under consideration. AIA supports the four proposals that will clarify provisions in the Dodd-Frank Act to better reflect the business and regulatory distinctions between banks and insurers. But, AIA cannot support expansion of the risk retention group authority to write additional commercial property-casualty insurance lines, as it may be inconsistent with the broader regulatory emphasis on sound financial condition and policyholder protection. AIA looks forward to working with Congress, our industry's regulators, and other stakeholders to ensure that insurance regulatory modernization and implementation of the Dodd-Frank Act, as applied to property-casualty insurers, reinforces the insurance business model and promotes market competition while protecting policyholders.

FINANCIAL SERVICES ROUNDTABLE

THE FINANCIAL SERVICES ROUNDTABLE

Subcommittee Hearing Entitled

"Legislative Proposals to Reform Domestic Insurance Policy"

Subcommittee on Housing and Insurance
The Committee on Financial Services

Tuesday, May 20, 2014

Thank you, Chairman Neugebauer and Ranking Member Capuano for holding this important Subcommittee hearing entitled "Legislative Proposals to Reform Domestic Insurance Policy." The Financial Services Roundtable (FSR) appreciates the opportunity to submit testimony for the record.

Although the Subcommittee hearing is focused on multiple legislative proposals, FSR elected to focus its comments on H.R. 4510, the "Insurance Capital Standards Clarification Act of 2014." This legislation, championed by Reps. Miller and McCarthy, and supported by many others, is a critical proposal that recognizes insurers' unique capital, risk, and business models.

The Financial Services Roundtable

The Financial Services Roundtable is a leading advocacy organization that represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine, accounting directly for $92.7 trillion in managed assets, $1.2 trillion in revenue, and 2.3 million jobs.

As referenced above, FSR represents both banking and insurance organizations and is, as a result, uniquely positioned to understand the different business, capital, and risk models in those different sectors. FSR believes the businesses are different and the capital standards applied to each should be tailored appropriately.

Federal Reserve Supervision

The Dodd-Frank Act (DFA) charged the Federal Reserve Board (Federal Reserve) with establishing minimum leverage and risk-based capital standards for insurance companies that own Savings and Loan Holding Companies (SLHC) and non-bank entities designated Systemically Important Financial Institutions (SIFIs) by the Financial Stability Oversight Council (FSOC).

According to Section 171 of the DFA, also known as the Collins Amendment, these capital and leverage requirements "shall not be less than the generally applicable risk-based capital requirements that the agency may require, nor quantitatively lower than the generally applicable risk-based capital requirements that were in effect for insured depository institutions as of date of enactment of this Act." This could potentially lead to the Federal Reserve applying Basel III's bank-centric leverage and capital standards to insurers.

The Differences Between Banking and Insurance

Applying bank-centric leverage and capital requirements, as contemplated in Basel III, to insurance companies ignores fundamental differences between banks and insurers.

Banks are funded largely through short-term borrowing and deposits that can be withdrawn at any time. The ability for depositors to withdraw their funds on-demand leaves the institution vulnerable to a "run," in which large amounts of the institution's deposits are withdrawn quickly. Such a "run on the bank" could, if large enough, undermine capital levels of the bank.

Insurers, however, are funded through long-term liabilities. In the insurance model, assets and liabilities are generally linked and are comparatively longer term and more diversified than those of the banking sector. While insurers must have enough capital available to compensate policyholders in the event of a claim or similar payout trigger, these liabilities are not subject to a "run" in the same manner that banks are through their on-demand redemptions. An insurer's obligation to pay typically depends on the occurrence of a covered event, commonly exogenous in nature. Thus, an insurance policy is not an instrument that permits insurance consumers to have on-demand access to the assets of their insurers. Further, insurers are highly regulated with regard to required reserves to cover claims, both known and anticipated.

In addition to the different funding models, insurers invest in long-term assets to match the duration of their long-term liabilities. These stable, longer term assets, also subject to strict state regulation, can buffer insurers in times of economic and financial distress; this attribute should inform the type of capital and leverage requirements to which insurers are subject.

These two fundamental attributes of insurance require leverage and capital requirements specifically formulated for the insurance business model.

Federal Reserve Authority

Federal Reserve officials, including new Chair Janet Yellen, have noted the differences in the business models of banking and insurance and the need to tailor capital standards:

> We [Federal Reserve] recognize that there are very significant differences between the business models of insurance companies and the banks that we supervise, and we are taking the time that's necessary to understand those differences and to attempt to craft a set of appropriate capital and liquidity requirements that will be appropriate to the business model of insurance companies.

Despite that understanding, the Federal Reserve has noted that the language in the DFA limits its flexibility to tailor capital standards to insurers. Although the Federal Reserve notes that DFA language constrains its ability to tailor standards, FSR believes the existing language allows the Federal Reserve to establish and apply tailored capital and leverage requirements to insurers that own savings and loan holdings companies or which have been or are designated as SIFIs. Many, including FSR, welcomed the Federal Reserve's July 2013 decision to temporarily exempt insurance companies from final Basel III framework until it determined the appropriate framework.

Senator Collins, the author of the Collins Amendment, has also indicated that she did not intend for insurers to be subject to the same capital requirements as banks. In her November 2013 letter to the Federal Reserve, the Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, on the topic, Senator Collins explicitly asserts that "it was not Congress's intent that the federal regulators supplant prudential state-based insurance regulation with a bank-centric capital regime." Senator Collins continues, asserting that "consideration should be given to the distinctions between banks and insurance companies."

It is clear that the author of the amendment, uniquely qualified to express Congressional intent on this issue, did not intend for bank-centric capital and leverage requirements to be applied to insurers. FSR supports her assertion and believes the Federal Reserve has the authority under the existing statute to apply separate and tailored standards to insurers that own SLHCs or are designated SIFIs.

Legislation Proposals

Although FSR believes the Federal Reserve has the authority to tailor capital standards, we also support legislative proposals that would provide additional clarity and further signal Congressional intent to the Federal Reserve.

To that end, FSR supports H.R. 4510, the "Insurance Capital Standards Clarification Act of 2014," which would provide additional flexibility to the Federal Reserve to establish capital standards that are properly tailored to the unique characteristics of the business of insurance. This legislation has bipartisan support; we understand that the Federal Reserve also supports the legislation's intent.

H.R. 4510 would enable the Federal Reserve to develop tailored, more appropriate capital standards. It would not, however, dilute the Federal Reserve's authority to apply appropriate standards to the insurer holding company or its depository institutions that the Federal Reserve supervises, including those owned by an insurer. This flexibility ensures that the Federal Reserve develops adequate standards to bolster the safety and soundness of the financial system and that banks and insurers are subject to appropriate standards tailored to their business, risk, and capital profiles.

FSR applauds Representatives Miller and McCarthy, as well as so many other House members that support this legislation.

Importantly, Senators Collins, Brown, and Johanns have also introduced legislation to accomplish this goal. FSR applauds these Senators for their hard work and leadership to advance this important public policy goal.

Conclusion

Insurers have a different capital, risk, and business model than banks. This is true whether an insurer owns an SLHC or is designated a SIFI. It is important that the Federal Reserve draft appropriate and tailored capital and leverage standards to reflect those differences. Doing so not only allows for the insurer to function more effectively, but better protects the safety and soundness of the insurance marketplace and the consumers it serves.

FSR believes that the Federal Reserve has the authority to develop and apply separate, tailored standards under existing powers. To help clarify the Federal Reserve's authority and reinforce Congressional intent, FSR supports legislation, specifically, H.R. 4510, the "Insurance Capital Standards Clarification Act of 2014" which further clarifies the Federal Reserve's flexibility.

FSR thanks Chairman Neugebauer and Ranking Member Capuano for holding this important hearing and the opportunity to submit comments for the record. We look forward to assisting the Subcommittee in any way we can in its important work on these and other issues.

Statement on Behalf of the
Independent Insurance Agents and Brokers of America
Before the
United States House of Representatives
Committee on Financial Services
Subcommittee on Housing and Insurance

For the Hearing Entitled:
"Legislative Proposals to Reform Domestic Insurance Policy"

May 20, 2014

The Independent Insurance Agents and Brokers of America (IIABA) is pleased to provide the following comments and observations in advance of the Housing and Insurance Subcommittee's hearing entitled "Legislative Proposals to Reform Domestic Insurance Policy." We welcome the opportunity to provide our perspective on several of the legislative proposals that will be examined by your subcommittee, and we look forward to working with you and your colleagues on any insurance-related legislation that might subsequently advance through the legislative process.

IIABA supports the adoption of the proposed Insurance Data Protection Act, drafted by Rep. Steve Stivers. The Federal Insurance Office (FIO) and the Office of Financial Research (OFR) possess sweeping subpoena power that can be abused if suitable safeguards are not put into place, and this proposal would institute appropriate procedural protections that must be satisfied before these entities may demand the production of information in this manner. The bill would ensure, for example, that any information demanded is not obtainable by other means, that there is proper coordination among regulators, that any information received remains confidential, and that the Congressional committees with jurisdiction are informed of the extent to which this broad authority is utilized. This proposal institutes important procedural

requirements that are consistent with FIO's non-regulatory mission and narrow role, and IIABA urges its swift adoption.

IIABA similarly supports the adoption of H.R. 4510, the Insurance Capital Standards Clarification Act. This proposal recognizes the unique nature of insurers and the inherent distinctions between the banking and insurance industries, and it would clarify that insurance companies subject to Federal Reserve oversight are not forced to comply with bank-centric capital standards. While this measure does not affect independent agents and brokers as directly as it does those in the insurer community, we encourage the subcommittee to take action on this important measure.

IIABA also welcomes the introduction and consideration of H.R. 4557, the Policyholder Protection Act. This common-sense proposal ensures that insurers organized as either bank holding companies or thrift holding companies are treated similarly in the event that an affiliate of an insurer becomes financially troubled. The proposal eliminates the uncertainty and concern that currently exists by applying the same standards to thrift holding companies, and it protects consumers who secure insurance coverage and protection from an insurer affiliated with such a holding company. Similar to H.R. 4510 this measure does not directly affect IIABA members. While IIABA has no formal position on this bill, we commend Rep. Posey for addressing this important subject.

Finally, IIABA also appreciates the subcommittee's examination of the draft Risk Retention Modernization Act, a proposal that would broadly expand the lines of insurance that risk retention groups may provide and that risk purchasing groups may obtain. Similar legislation has been proposed at various times over the last decade, and the controversial nature of the proposals has slowed their movement through the legislative process. Our association has not taken a formal position concerning the discussion draft released in advance of the hearing, but we do have several questions and concerns as a result of our initial review of the proposal:

- Previous proposals would have allowed risk retention groups to expand offerings to include commercial property insurance, yet the discussion draft goes further and would authorize an expansion to nearly all forms of commercial insurance. The initial act was passed by Congress in the 1980s as a response to a severe marketplace crisis that made it effectively impossible for some businesses to obtain liability insurance, and IIABA questions whether there is marketplace dysfunction on a national level to warrant the expansion of the act.

- The draft raises questions about the role that state officials might play in the oversight and regulation of those risk retention groups that would offer new commercial lines products, and we fear some of the requirements set forth in the discussion draft (especially those related to financial regulation and solvency) might be viewed as a ceiling and not a floor.

- The addition of a new commercial lines-specific preemption provision is also a source of potential concern for IIABA, and we also wonder about the exclusion of certain consumer protection provisions that were included in similar versions of this legislation in the past.

We thank you for the opportunity to submit these comments and look forward to working with you in the weeks and months to come.

NAIC National Association of Insurance Commissioners & The CENTER for INSURANCE POLICY and RESEARCH

May 20, 2014

Chairman Randy Neugebauer
Subcommittee on Housing and Insurance
Committee on Financial Services
U.S. House of Representatives
2129 Rayburn House Office Building

Ranking Member Michael Capuano
Subcommittee on Housing and Insurance
Committee on Financial Services
U.S. House of Representatives
B301-C Rayburn House Office Building

Dear Chairman Neugebauer and Ranking Member Capuano:

On behalf of the National Association of Insurance Commissioners (NAIC)[1], we write today in support of H.R. 4510, the "Insurance Capital Standards Clarification Act of 2014" and H.R. 4557, the "Policyholder Protection Act of 2014."

As the regulators of insurance in the U.S., we are keenly aware of the many complicated considerations involved in setting capital standards appropriate for insurers, which necessarily have different risk profiles and liquidity needs than banks. H.R. 4510 seeks to address potential confusion with respect to the requirements that should apply to Savings and Loan Holding Companies (often referred to as "Thrift Holding Companies") with significant insurance operations or insurers that are designated systemically important financial institutions. We have long had concerns that the application of bank-like capital standards to insurance companies is not only inappropriate but could be detrimental to policyholder protection and financial stability. H.R. 4510 addresses this concern by ensuring that the Federal Reserve has the flexibility to tailor capital requirements appropriate to the insurance business model and is not otherwise statutorily bound to impose "one size fits all" bank centric standards.

We also write today in strong support of H.R. 4557, which provides assurance that critical regulatory protections for policyholders will be consistent across insurer organizational structures. This bill clarifies that state regulators can preserve the walls around insurance legal entities that have protected policyholders for more than 150 years. Our state based regulatory regime is designed with the primary mission of protecting policyholders by ensuring that a company has sufficient funds to pay insurance claims when they come due. One of the most important tools state regulators have to carry out this mission is the ability to protect or "wall off" the insurance legal entity from contagion in the rest of the company by preventing its funds or other assets from being used by other affiliated entities.

In cases where an insurance company is affiliated with a bank, it is subject to additional supervision by banking regulators. Where an insurer is organized as a Bank Holding Company, the Bank Holding Company Act contains procedural protections that limit banking regulators' ability to compel the movement of funds or other assets from the insurer to a troubled bank within the group. However, at this time, most insurance companies affiliated with banks are organized as Savings and Loan Holding Companies. The law governing

[1] Founded in 1871, the NAIC is the U.S. standard-setting and regulatory support organization created and governed by the chief insurance regulators from the 50 states, the District of Columbia and the five U.S. territories. Through the NAIC, state insurance regulators establish standards and best practices, conduct peer review, and coordinate their regulatory oversight. NAIC members, together with the central resources of the NAIC, form the national system of state-based insurance regulation in the U.S.

Savings and Loan Holding Companies does not contain the same protections, and the source of financial strength provisions in the Dodd-Frank Act call into question whether policyholders are protected in the Savings and Loan Holding Company context.

This is a serious source of concern for state insurance regulators. If a healthy insurer, organized as a Savings and Loan Holding Company, were compelled by the banking regulators to use its resources to provide funds or other assets to a troubled affiliate, the insurer's ability to pay out claims could be undermined and consumers could be harmed. In certain scenarios it is possible that an insurance company could even become insolvent as a result, and policyholders might not obtain the full value of the promise their premiums paid for. While insurance regulators recognize that there may be circumstances where it may be appropriate for an insurer to provide assistance to a troubled affiliated bank, forcibly removing funds or other assets from an insurer to bail out a troubled bank should not be done at the expense of policyholders, and certainly not without the protections afforded by the Bank Holding Company Act.

H.R. 4557 addresses this concern by ensuring that the protections afforded to policyholders of insurance companies in Saving and Loan Holding Company systems match those in Bank Holding Company systems and those that are not affiliated with a bank. By ensuring the same policyholder protections exist to irrespective of an insurance company's structure, H.R. 4557 helps guarantee that a promise made by an insurance company is a promise kept. Consumers who have come to rely on insurance policies issued by companies in Saving and Loan Holding Company systems to protect their home, livelihood, or retirement will have the same protections as those who purchased their policy from other types of insurance companies

We commend Congressman Posey for introducing and Congressman Sherman for co-sponsoring this common-sense piece of legislation that protects policyholders in Thrift Holding Company systems. We urge you to support this important effort to enhance consumer protection. Should you wish to discuss this letter or any other matter relating to the NAIC's views on this legislation, please do not hesitate to contact Ethan Sonnichsen, Director of Government Relations, at (202) 471- 3980 or Mark Sagat, Counsel and Manager, Financial Policy and Legislation, at (202) 471-3987.

Sincerely,

Adam Hamm
NAIC President
North Dakota Insurance Commissioner

cc: The Honorable Bill Posey, U.S. House of Representatives
The Honorable Brad Sherman, U.S. House of Representatives
The Honorable Gary Miller, U.S. House of Representatives
The Honorable Carolyn McCarthy, U.S. House of Representatives

Statement for the Record

May 20, 2014

Submitted to the

Subcommittee on Housing and Insurance

The Committee on Financial Services of the

United States House of Representatives

by the

Property and Casualty Insurers Association of America (PCI)

The Property Casualty Insurers Association of America (PCI) appreciates the opportunity to submit the following statement regarding the Risk Retention Act Modernization discussion draft for the record. PCI is a trade association composed of more than 1,000 member companies, representing the broadest cross section of insurers of any national trade association. In fact, PCI members include six risk retention groups writing almost $250 million in annual premium. Overall, PCI members write more than $195 billion in annual premium and 39 percent of the nation's home, auto and business insurance, epitomizing the diversity and strength of the U.S. and global insurance markets.

PCI supports the Risk Retention Act Modernization discussion draft. PCI's mission is to promote and protect the viability of a competitive private insurance market for the benefit of consumers and insurers. PCI's principles of good insurance regulation include the recognition of a wide variety of property-casualty business models to increase private competition. Expanding the ability of Risk Retention Groups to offer coverage with appropriate regulatory oversight and protections can expand competition for consumers.

In the 1970s, product liability insurance became increasingly costly and unavailable. In response, in 1981, Congress passed the "Product Liability Risk Retention Act" that allowed product manufacturers and distributors to band together to form their own self-insurance "risk retention groups" (RRGs) for product liability insurance. In the mid-1980s, general liability (and other commercial liability) insurance premiums skyrocketed and coverage for certain liability exposures was unavailable in the standard marketplace or extremely expensive for the desired limits and coverages. Among the entities particularly hard hit during this crisis were nonprofits, universities, municipalities, daycare centers, health care providers, and small businesses. In 1986, Congress further expanded the 1981 Act to permit Risk Retention Groups (RRGs) to cover broader liability risks. The Act is now referred to as the Liability Risk Retention Act (LRRA).

RRGs are unique, industry-specific groups that must be made up of similarly-situated entities, with similar risk exposures, that pool their risk to self-insure their liability on a group basis. RRGs are insurers licensed and fully regulated in one state pursuant to that state's laws. Each state, in turn, is accredited by the National Association of Insurance Commissioners (NAIC). Under the LRRA, once licensed in one accredited state, an RRG then "registers" in non-domiciliary states and provides those states with ongoing information about the RRG's financial condition and business in each state.

The LRRA currently limits RRGs to providing commercial liability insurance. One of the requirements is that all owners of an RRG must also be insured by the RRG and that all insureds must be owners. In the more than quarter century since the 1986 Amendment, more than 250 risk retention groups have aggregated more than $2.5 billion in gross written premiums. In 2005, a study by the Government

Accountability Office found that "RRGs have had a small but important effect in increasing the availability and affordability of commercial liability insurance for certain groups..." In their 2012 update, the GAO found that "the financial condition of the RRG industry in aggregate generally has remained profitable. In 2010, RRGs continued to comprise a small percentage of the total market, writing about $2.5 billion—or about 3 percent of commercial liability coverage." The GAO also noted that, "[i]n 2005, GAO recommended implementation of more uniform, baseline state regulatory standards, including corporate governance standards to better protect RRG insureds. The National Association of Insurance Commissioners (NAIC) has since revised its accreditation standards to more closely align with those for traditional insurers which are subject to oversight in each state in which they operate. For example, all financial examinations of RRGs that have commenced during or after 2011 should use the risk-focused examination process. NAIC also has begun developing corporate governance standards that it plans to implement in the next few years."

The Risk Retention Act Modernization discussion draft would expand the LRRA to allow RRGs to provide all commercial property casualty lines of coverage except workers' compensation, so long as the RRG has been a state licensed insurer for at least five consecutive years and maintains at least $5 million capital and surplus.

PCI supports the expansion of the LRRA to allow RRGs to provide commercial insurance other than worker's compensation so long as the RRGs continue: to be excluded from the state guaranty funds for property-casualty insurance; to have full solvency regulation by domiciliary state (including participation in NAIC solvency monitoring mechanisms); to be subject to non-domiciliary regulators; continue to have some degree of solvency regulation including examination and order of delinquency in situations where an RRG is financially impaired; to comply with injunctions issued by a court upon petition by a state insurance commissioner where the group is found to be in a hazardous financial condition or financially impaired; to comply with state laws governing deceptive, false or fraudulent acts or practices; to comply with unfair claims settlement practice laws; to pay applicable premium and other taxes; and to participate in residual market programs to the extent required by each state. The current Risk Retention Act Modernization discussion draft does not undermine any of these criteria applicable to RRGs.

The LRRA has existed in its present form for 28 years as a state regulated competitive business model. Given the requirements detailed above, PCI supports the ability of RRGs to offer expanded commercial insurance coverage, using well-established principles of risk management, broad coverage, stable pricing and coordinated claims services.

PCI looks forward to working with the Subcommittee on Housing and Insurance, state insurance regulators, and educational institutions, nonprofits, and businesses to further refine legislative language that builds on the successes achieved through the LRRA while preserving the important solvency protections of the existing state system of insurance regulation that helped the robust U.S. insurance marketplace, including RRGs, to remain strong throughout the recent financial crisis.