The Impact of Dodd-Frank's Insurance Regulations on Consumers, Job Creators and the Economy

House Financial Services Subcommittee on Insurance, Housing and Community Opportunity

Testimony of

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Thank you, Representative Biggert, Ranking Member Gutierrez and members of the Committee.

Good afternoon. My name is Robert Hartwig and I am President and Economist for the Insurance Information Institute, an international property/casualty insurance trade association based in New York City.[1] I am also a Chartered Property Casualty Underwriter (CPCU) and have worked on a wide variety of insurance issues during my 19 years in the property/casualty insurance and reinsurance industries, including many related to the industry's financial performance, capital requirements and structure. The Institute's members account for nearly 70 percent of all property/casualty insurance premiums written in the United States. Its primary mission is to improve understanding of the insurance industry and the key role it plays in the global economy.

I have been asked by the Committee to provide testimony on the role of the insurance industry and the benefits that insurance products and services provide to consumers, job creators and the economy. I've also been asked to address concerns associated with certain Dodd-Frank provisions affecting insurers that could raise compliance costs or adversely affect the structure, capacity or ability of the insurance industry to absorb risk.

The Role of Insurance in the Economy

Insurance is a financial risk management tool that allows individuals and businesses to reduce or avoid risk through the transfer, pooling or sharing of risk to a third party. While various risk-sharing arrangements have been in existence for millennia, in modern times that risk is usually contractually transferred (via an insurance policy) to and absorbed by an insurance company. In return for a payment (i.e., the premium), the insurer assumes the risks—that is, obligates itself to pay the losses—of all policyholders.

This simple, efficient and effective arrangement allows the insured party to be protected against a multitude of potentially ruinous losses and instead focus on activities that produce or preserve income and wealth and contribute to the creation of jobs by fostering investment, innovation and entrepreneurship.

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Because virtually any risk that can be quantified can be insured—the use of insurance has, over time, become commonplace in most advanced economies. In 2010, worldwide combined property-casualty and nonlife insurance premiums totaled $4.3 trillion representing 6.9 percent of global Gross Domestic Product (GDP). Collectively, these premiums reflect the transfer of hundreds of trillions of dollars in risk exposure to insurance companies around the world. Consequently, the welfare enhancing benefits of insurance are ubiquitous throughout the economy and society as a whole. No modern economy could function as efficiently without widespread use of insurance and many activities in today's disaster-prone and heavily litigious society would be impossible altogether.

Scale and Scope of the Insurance Industry in the United States

The essential nature of insurance has given rise to a very large and dynamic industry in the United States with more than a $1 trillion in annual premium income, $4.5 trillion in assets and some 2.2 million employees. Below are some facts that summarize some key statistics related to the insurance industry in the United States:

- The U.S. insurance industry's net premiums written exceeded $1.0 trillion in 2010, with premiums recorded by life/annuity (L/A) insurers accounting for 58 percent and premiums by property/casualty (P/C) insurers accounting for 42 percent, according to SNL Financial.

- There were 2,689 P/C insurance companies and 1,061 L/A and health insurance companies in the United States in 2010.

- Insurance carriers (including health insurers) and related activities accounted for $404 billion, or 2.8 percent of U.S. gross domestic product in 2009.

- The U.S. insurance industry employed 2.2 million people in 2010. Of those, 1.4 million worked for insurance companies, including life, health and medical insurers (807,300 workers), P/C insurers (533,100 workers) and reinsurers (27,100 workers). The remaining 870,500 people worked for insurance agencies, brokers and other insurance-related enterprises.

- Total P/C cash and invested assets were $1.3 trillion in 2010. L/A cash and invested assets totaled $3.2 trillion in 2010.

- The majority of insurance industry assets are held as bonds (66 percent of P/C assets and 76 percent of L/A assets).

- P/C and L/A insurance companies paid $15.8 billion in premium taxes in 2010, or $51 for every person living in the United States, accounting for 2.2 percent of all state tax revenue.

- P/C insurers paid out $32.3 billion in property losses related to catastrophes in 2011, the fifth highest year on record.

- Property/casualty insurance companies contributed $500 million to charities in 2010, benefiting communities in which they operate throughout the United States.

Exhibit 1 shows premiums written for the property-casualty and life/annuity segments of the insurance industry. With nearly $1.1 trillion in annual premium income, the industry is an important segment of the American economy by virtue of its sheer size. But size alone conveys only one dimension of the industry's importance. The benefits that accrue to individuals, businesses, the economy and society as a whole are many and varied in nature.

Benefits of Insurance: Property/Casualty and Life/Annuity

As discussed previously, insurance allow individuals and businesses to avoid or reduce many types of risk by transferring that risk to an insurance company. In the sections that follow, some of the more common types of insurance are discussed along with a brief description of the benefits to policyholders and the broader economy.

Property/Casualty Insurance

Property/casualty insurers provide protection in the form of monetary indemnification against a wide variety of situations in which a policyholder could suffer a financial loss. Auto and home insurance are two types of insurance that most people are familiar with and that together account for nearly half of all property/casualty insurance premiums written. In a typical year, auto and home insurers pay between $150 billion and $200 billion to hundreds of thousands of policyholders whose vehicles or homes were damaged or destroyed in accidents or by natural disasters as well as to individuals who suffered bodily injuries as the result of liability losses covered by these policies. A similar sum is paid each year to business owners for claims arising from a wide spectrum of property and liability claims, including injuries suffered by workers in occupational settings (via worker compensation insurance policies).

Life/Annuity Insurance

Life insurance provides individuals and families (beneficiaries) with financial protection against the possibility of loss of income due to death to an insured individual. An annuity, in its simplest form, is a contract between an individual and a life insurance company specifying a future stream or series of payments that will be made in exchange for a payment made to that insurance company today. The annuity arrangement allows the purchaser of the annuity to transfer to the insurer the risk associated with outliving one's assets.

Life and annuity insurers wrote a near-record $624 billion in premiums in 2011, the second highest total in history (see Exhibit 1). Recent growth is attributable to increased demand associated with mounting uncertainty over the adequacy of retirement income, as corporate pension plans become less common and concerns over the Social Security program continue to rise.

Risk Assumption, Insurer Strength and the Accumulation of Financial Resources

Because insurers assume trillions of dollars of exposure in exchange for premiums received from millions of policyholders each year, insurers necessarily hold assets large enough to pay any reasonable—and even highly improbable—levels of claim activity. The industry's assets must also be large enough to pay claims in times when asset values fluctuate as underlying market conditions shift due to developments in the financial markets and/or broader economy. Regulations, including Dodd-Frank, can also have an effect on the required quantity and composition of assets held.

As displayed in Exhibit 2, the combined assets of the property/casualty and life/annuity segments of the insurance industry totaled $4.51 trillion as of year-end 2010, up nearly $300 billion from $4.22 trillion at year-end 2008.

Likewise, the policyholder surplus of both property/casualty and life/annuity insurers is at all-time record highs (see Exhibit 3 and Exhibit 4, respectively). Policyholder surplus is effectively the net worth of the industry and reflects claims paying capacity and is a proxy for the supply of insurance available in the market.

The bottom line is that the insurance industry's capital resources are at or near all-time record highs and are growing. The strength of the industry is without parallel within the financial services segment. Property/casualty and virtually all life insurers, unlike banks, were able to operate normally throughout the entirety of the financial crisis and have continued to do so since that time. Consequently, financial industry regulations adopted in the wake of the crisis must avoid imposing bank-centric regulations on the insurance industry, whose operating record and business model are distinct from that of the banking sector.

Insurers: Among the Largest of All Institutional Investors

The insurance industry's need to maintain large holdings of assets to back claims and satisfy regulator and ratings agency requirements implies that the industry is one of the largest institutional investors in world. Indeed, the industry is usually ranked among the top three institutional investors across a broad range of asset categories. Exhibit 5 shows the distribution of the $1.3 trillion in investments held by property/casualty insurers as of year-end 2010. Exhibit 6 displays the same information for $3.3 trillion in invested assets held by life/annuity insurers.

Insurers are necessarily conservative investors and as such concentrate their investments in relatively low risk, highly liquid securities, especially bonds. The industry's conservative portfolio allocation is immediately obvious, with property/casualty insurers holding two-thirds of their invested assets in the form of bonds (Exhibit 5) with life/annuity insurers holding three-quarters of their portfolio in fixed income securities.

The sheer size of the industry's investment portfolio suggests that its role as an institutional investor is important on many levels. It is worth noting, for example, that 44 percent of the property/casualty insurance industry's bond portfolio is invested in municipal securities ("munis") issued by all fifty states and thousands of counties, cities and towns all across the United States (see Exhibit 7). In other words, property/casualty insurers alone in 2011 held bonds that served to finance some $331 billion in a wide array of projects such as schools, roads, bridges, mass transit initiatives and health care facilities. Life and annuity insurers held approximately 11 percent of their portfolio in such investments last year (Exhibit 8), translating into a $123 billion stake in state and local government financing (Exhibit 9). Hence collectively, the insurance industry has investments in state and local projects and initiatives that now exceed $450 billion.

Insurers as Employers

The insurance industry is an important employer in the United States. Exhibit 10 shows employment as of May 2012 across all segments of the insurance industry. Collectively, the industry employs nearly 2.3 million people. These figures include not only employees of insurance carriers themselves (which account for about 1.4 million or 61 percent of jobs in the industry), but also agents/brokers, third-party administrators and others. Exhibit 11 shows the number of people employed by insurance carriers (and related activities) by state in 2010. Insurers employ more than 100,000 people in seven states: California, Texas, New York, Florida, Pennsylvania, Illinois and Ohio—and at least 50,000 in an additional eight states. The wages and salaries paid to insurance industry employees totaled $196 billion in 2010, fueling local economic growth and supporting millions of secondary jobs across the country (see Exhibit 12).

Concerns Related to Financial Services Regulation: Dodd-Frank and Beyond

Property/casualty insurance is a large and vital industry in the United States. It is also a sound, stable, strong and secure industry, having earned a reputation for maintaining financial strength even when claim activity is far above expectations. The September 11, 2001, terrorist attacks, for example, resulted in $32.5 billion in insured losses (and more than one million claims paid)—then the most expensive event in global insurance history. In 2005, Hurricane Katrina produced $41.1 billion in claims—establishing a new record for insured losses from a single event that still stands to this day.

Insurers were able to meet the challenges of 9/11 and Hurricane Katrina (and a multitude of others) because of a long-standing operational philosophy that gives rise to a conservative underwriting and investment model. This same philosophy allows property/casualty insurers to continue with "business as usual" even during steep economic downturns, including the 2008 financial crisis and ensuing "Great Recession." Indeed, not a single traditional property/casualty insurer or reinsurer failed as a result of the financial crisis nor did a single legitimate claim go unpaid. In contrast, during the financial crisis and its aftermath, more than 400 banks failed.

It is important to recognize that in the decade leading up to the passage of the Dodd-Frank Act (DFA) in 2010, the property/casualty insurance industry experienced its largest claim events in history and weathered the worst recession since the Great Depression. The industry operated throughout this period without interruption and without undue concerns over insolvencies.

The evidence from that eventful decade was definitive proof that insurers are fundamentally different from banks. Indeed, Congress explicitly recognized this fact by largely leaving intact the existing system of state-based regulation under DFA.

Although Congress recognized the distinct nature of insurance in the drafting of DFA, that recognition is not complete. There is concern that several provisions of Dodd-Frank could ultimately reduce the ability of insurers to mitigate risk on their own books or adversely impact the amount of capital available for underwriting risk. For example, although DFA provides insurers with an exemption from the Volcker Rule, there is concern that financial institutions whose primary business is insurance but who have an affiliation with a bank could be adversely impacted by the Rule. The Volcker Rule effectively prohibits a bank (or institution that owns a bank) from engaging in proprietary trading that is not directed by or at the behest of its customers or from owning or investing in hedge funds or private equity funds. Because the Volcker Rule and its implementation with respect to insurers is still subject to study by the Financial Stability Oversight Council (FSOC) and the complexity of the Rule overall, there remains some uncertainty as to how the rule will be applied to property/casualty insurers that are affiliated with banks.

Other concerns voiced by some insurers include the possibility of "mission creep" by the newly created Consumer Financial Protection Bureau (CFPB), the eventual execution of subpoena authority granted to the new Federal Insurance Office, powers granted to the Federal Reserve following a Systemically Important Financial Institution (SIFI) designation, or expanded requirements for GAAP accounting in lieu of Statutory Accounting Principles (SAP).

Summary

Insurance is a very large, dynamic and essential component of the American economy and is important segment of the financial services industry. Property/casualty and life/annuity insurers operating in the United States today generate more than a $1 trillion in annual premium income, hold more than $4.5 trillion in assets and employ some 2.3 million people. It is an industry that is financial strong, stable, sound and secure—and remained as such during some of the most trying periods in economic and insurance history.

The Dodd-Frank Act in 2010 explicitly recognized the unique nature of insurance and that the business of insurance was not the cause of the financial crisis that began in 2008. Consequently, insurance was not the focus of the DFA and insurers were carved out or exempted from much of the regulation to which banks and other financial institutions were subjected. However, a number of provisions of Dodd-Frank, when fully implemented or because of potential misinterpretations of the Act's intent, could reduce the ability of insurers to accumulate capital or mitigate risk and there negatively impact the economy overall. These issues remain of concern to many insurers today.

Thank you for you for the opportunity to testify before the Committee today. I would be happy to respond to any questions you may have.

Exhibit 1

Insurance Industry Net Premiums Written, 2001-2011

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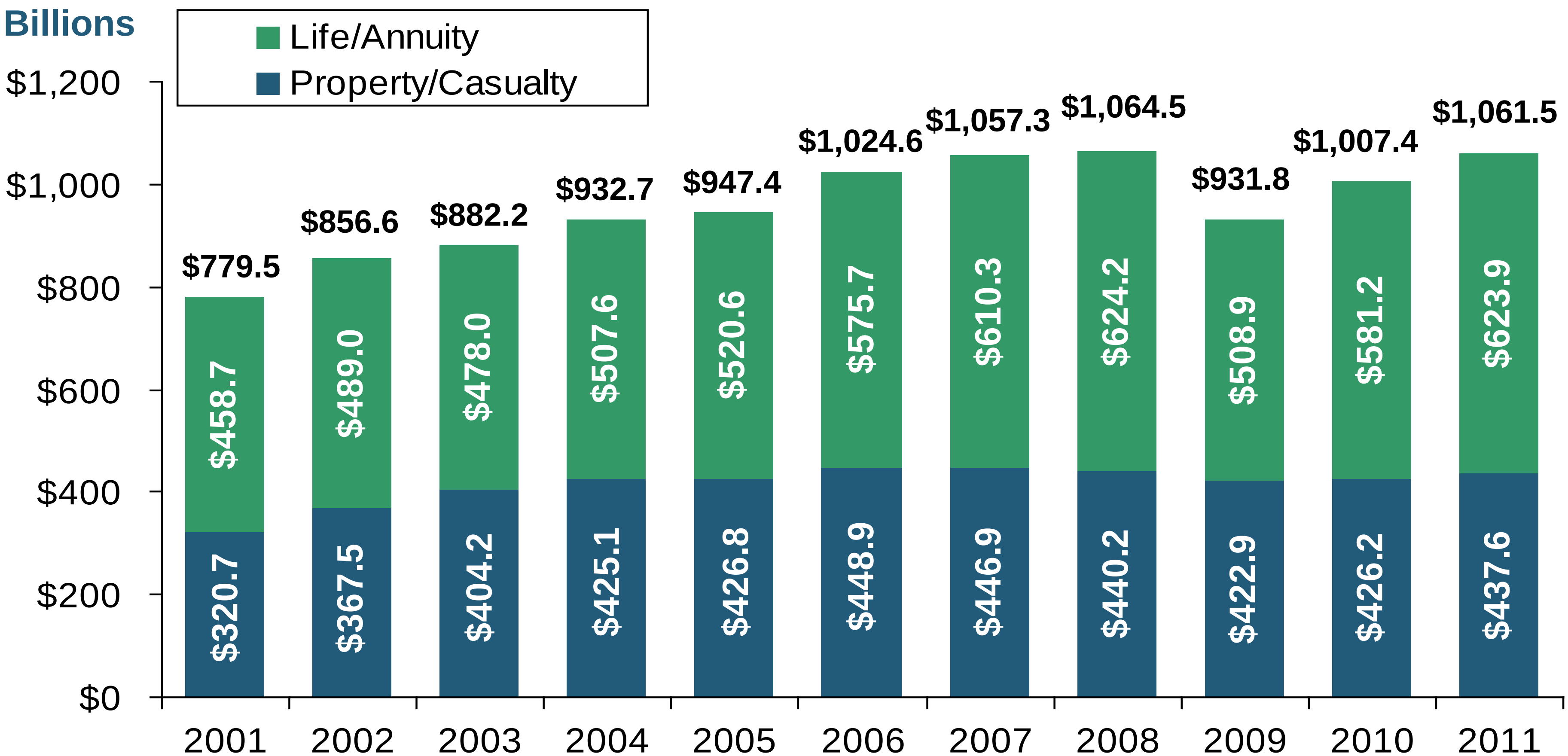


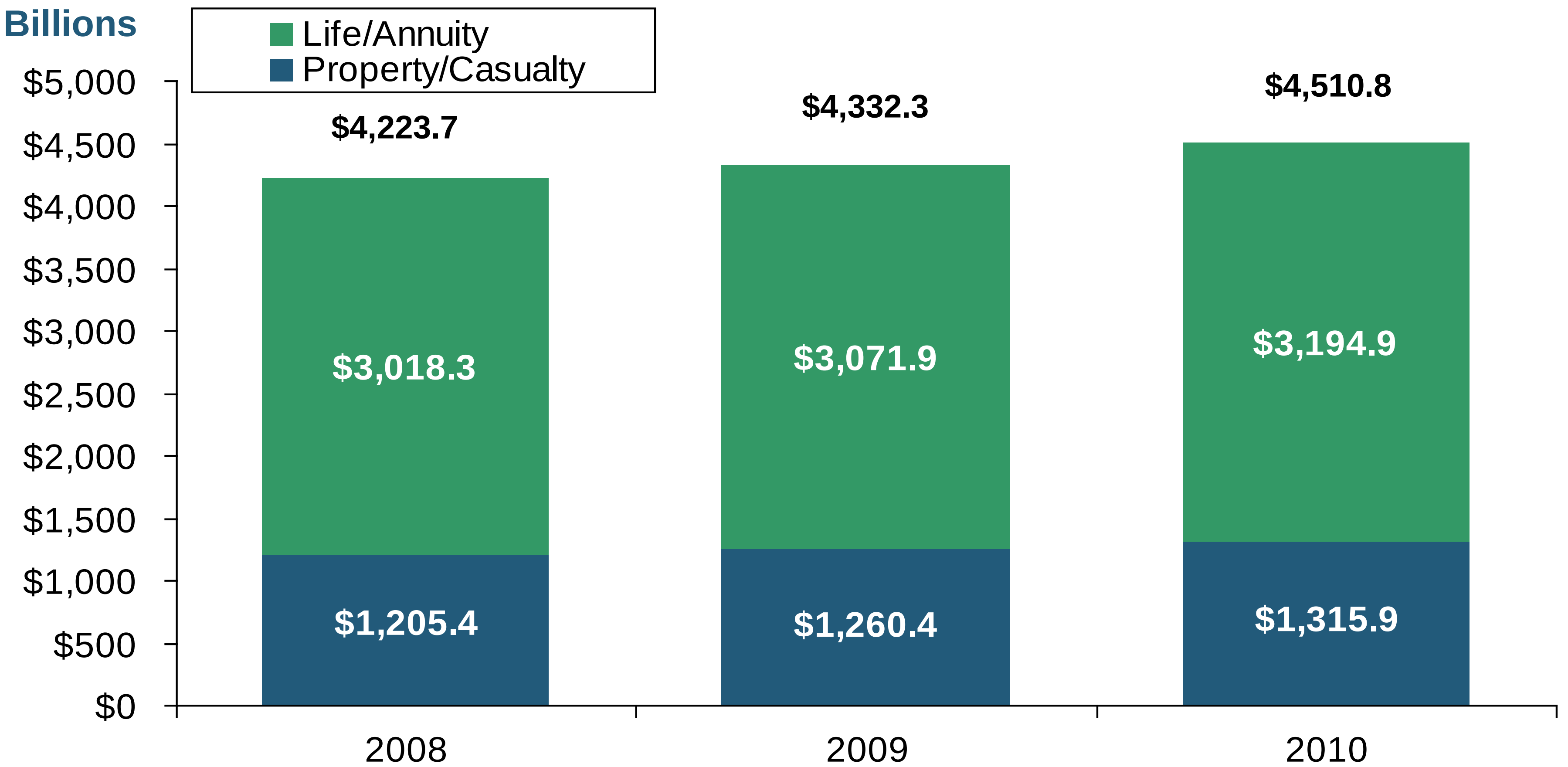
The property-casualty and life/annuity insurance industries wrote more than $1 trillion in premiums in 2010, up 36% form 2001. Insurance carriers (P/C and L/A) in the United States account for nearly 3% of GDP and employ nearly 1.3 million people.

Sources: NAIC Annual Statements, via SNL Financial; Insurance Information Institute.

Exhibit 2

Insurance Industry Assets, 2008-2010

INSURANCE INFORMATION INSTITUTE



The combined assets of the property/casualty and life/annuity segments of the insurance industry totaled $4.51 trillion as of year-end 2010. Despite a difficult economic and financial market environment, total assets are up by nearly $300 billion since 2008.

Sources: Insurance Information Institute, *2012 Insurance Fact Book*, via SNL Financial.

Exhibit 3

P/C Insurer Policyholder Surplus, 2006:Q4–2012:Q1

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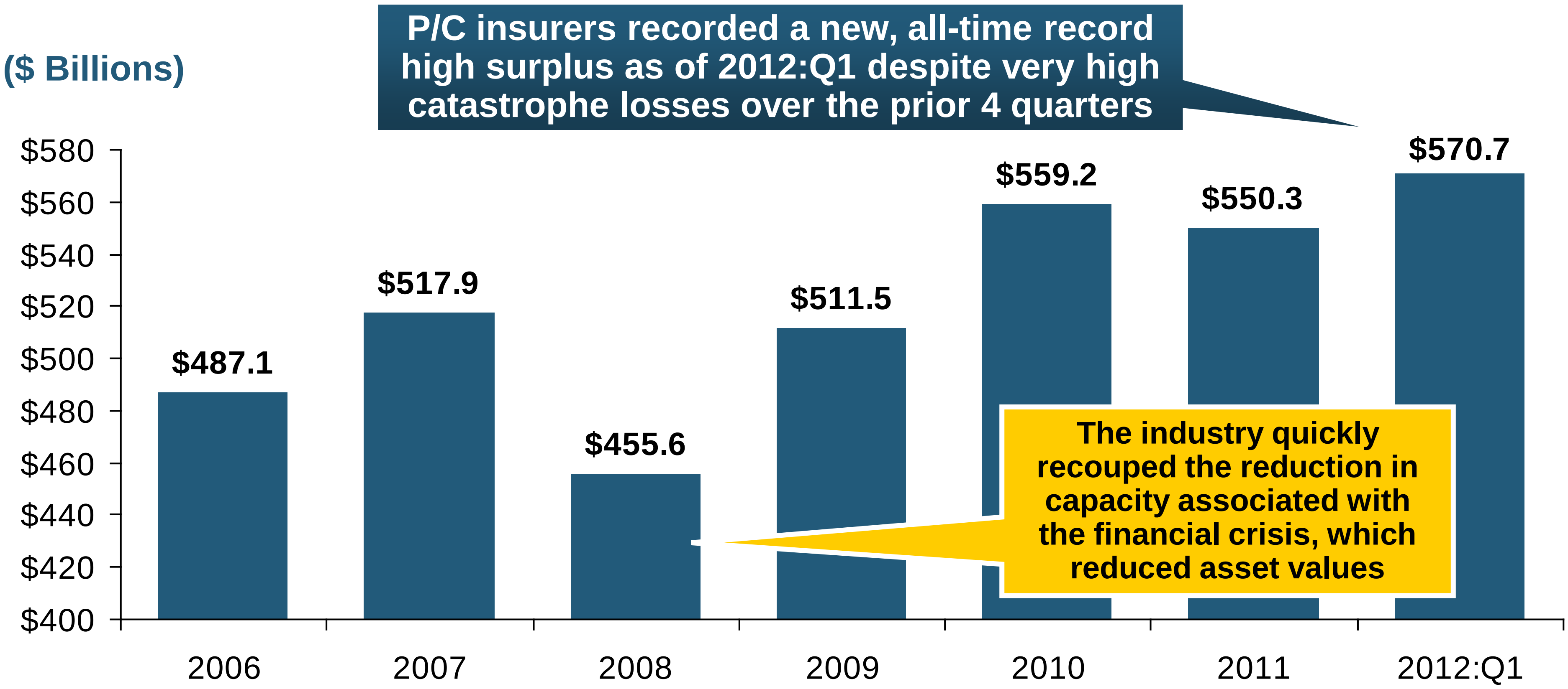
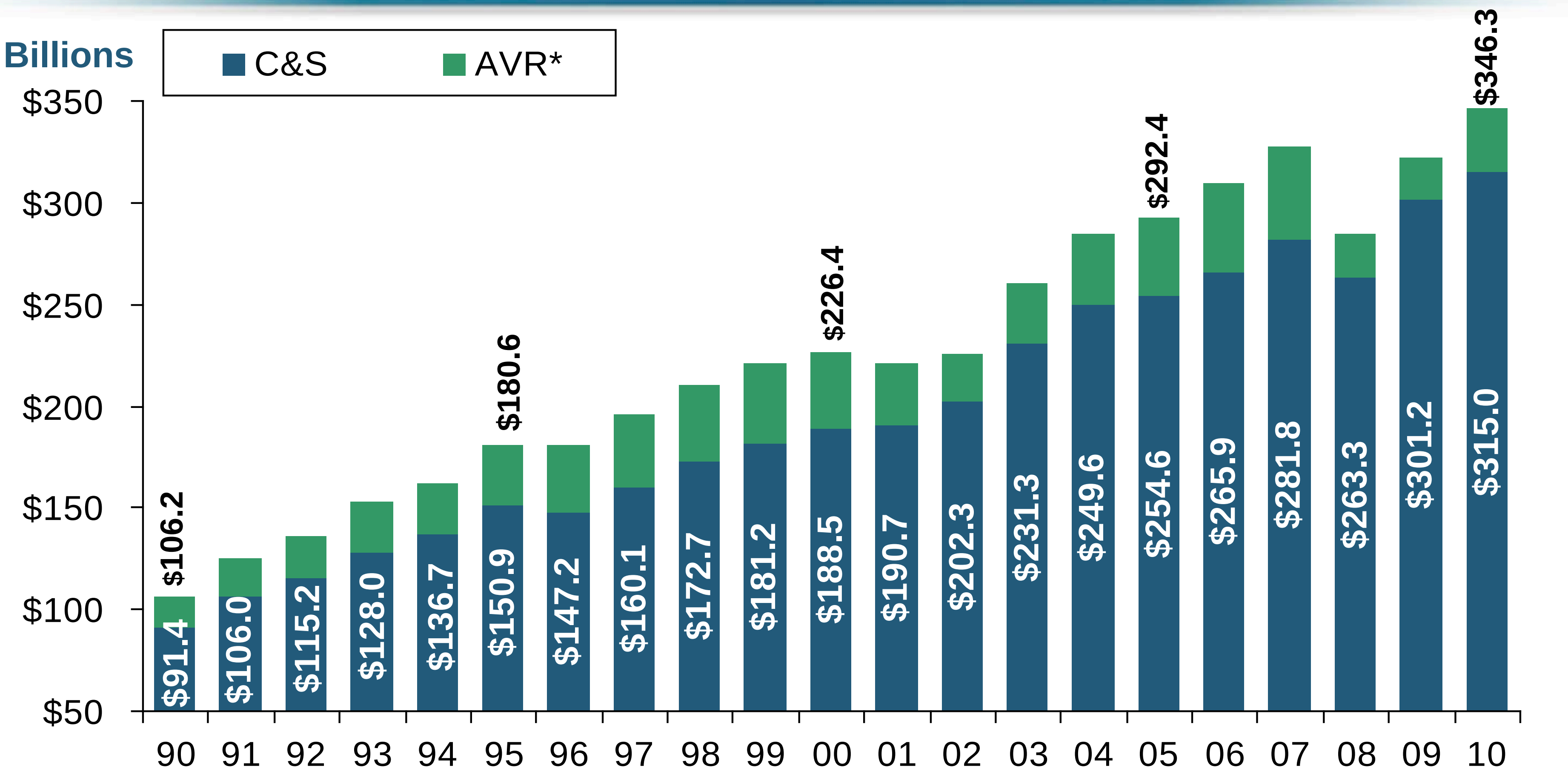


Property/Casualty insurer policyholder surplus is effectively the industry's net worth and represents the industry's claims paying capacity and is a proxy for the supply of insurance available in the market.

Sources: ISO, A.M .Best; Insurance Information Institute.

Exhibit 4

Life/Annuity Industry Capital & Surplus + AVR, General Account, 1990-2010



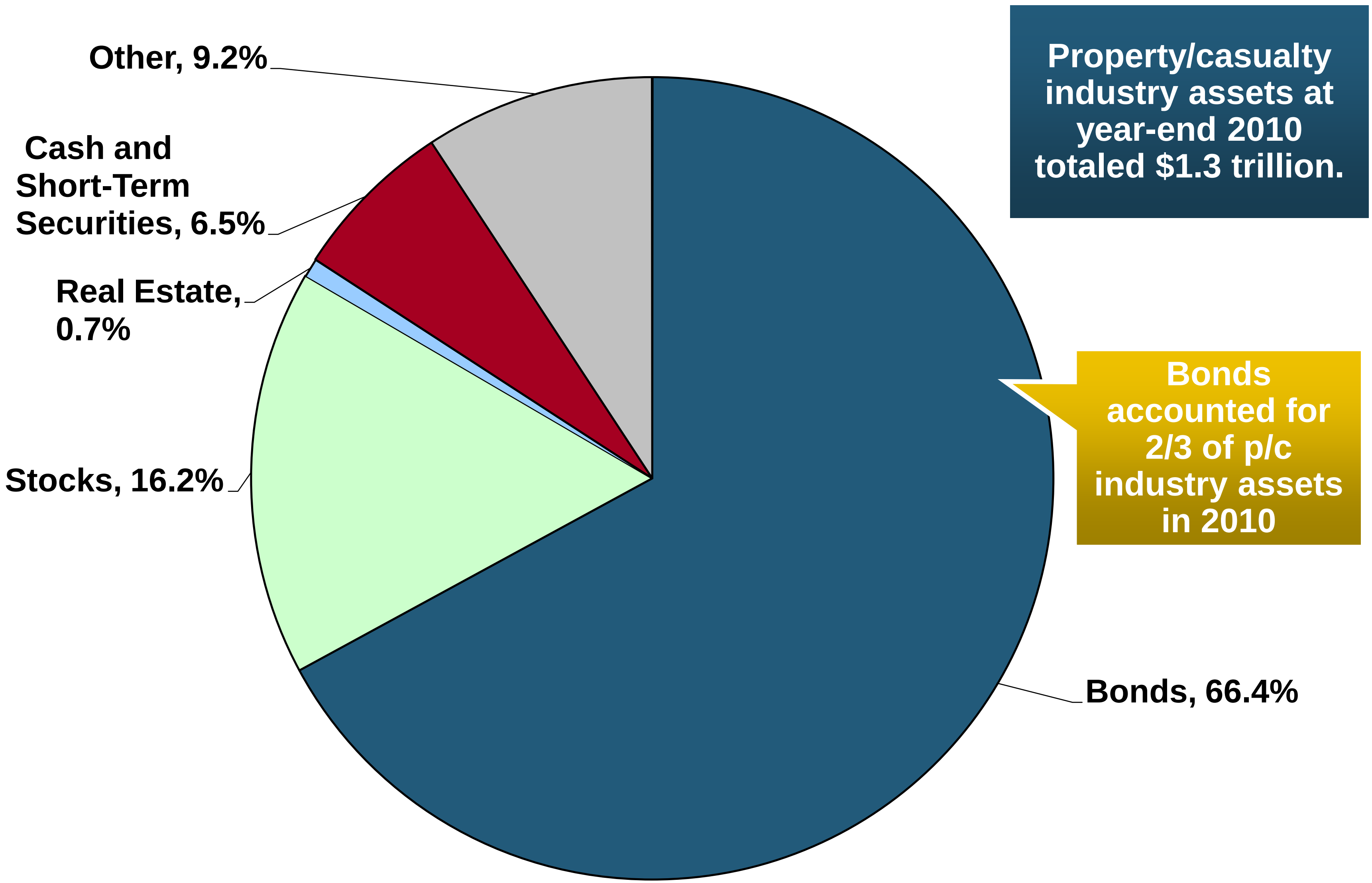
The Capital & Surplus (C&S) Account of Life/Annuity insurers has generally been increasing over time. The Asset Valuation Reserve (AVR), booked as a liability, is essentially an additional surplus account to "cushion" asset value drops. The industry has remained strong despite a challenging economic/financial environment.

*Prior to 1992, this was the Mandatory Securities Valuation Reserve (MSVR)

Sources: ACLI 2011 Life Insurance Fact Book; Insurance Information Institute.

Exhibit 5

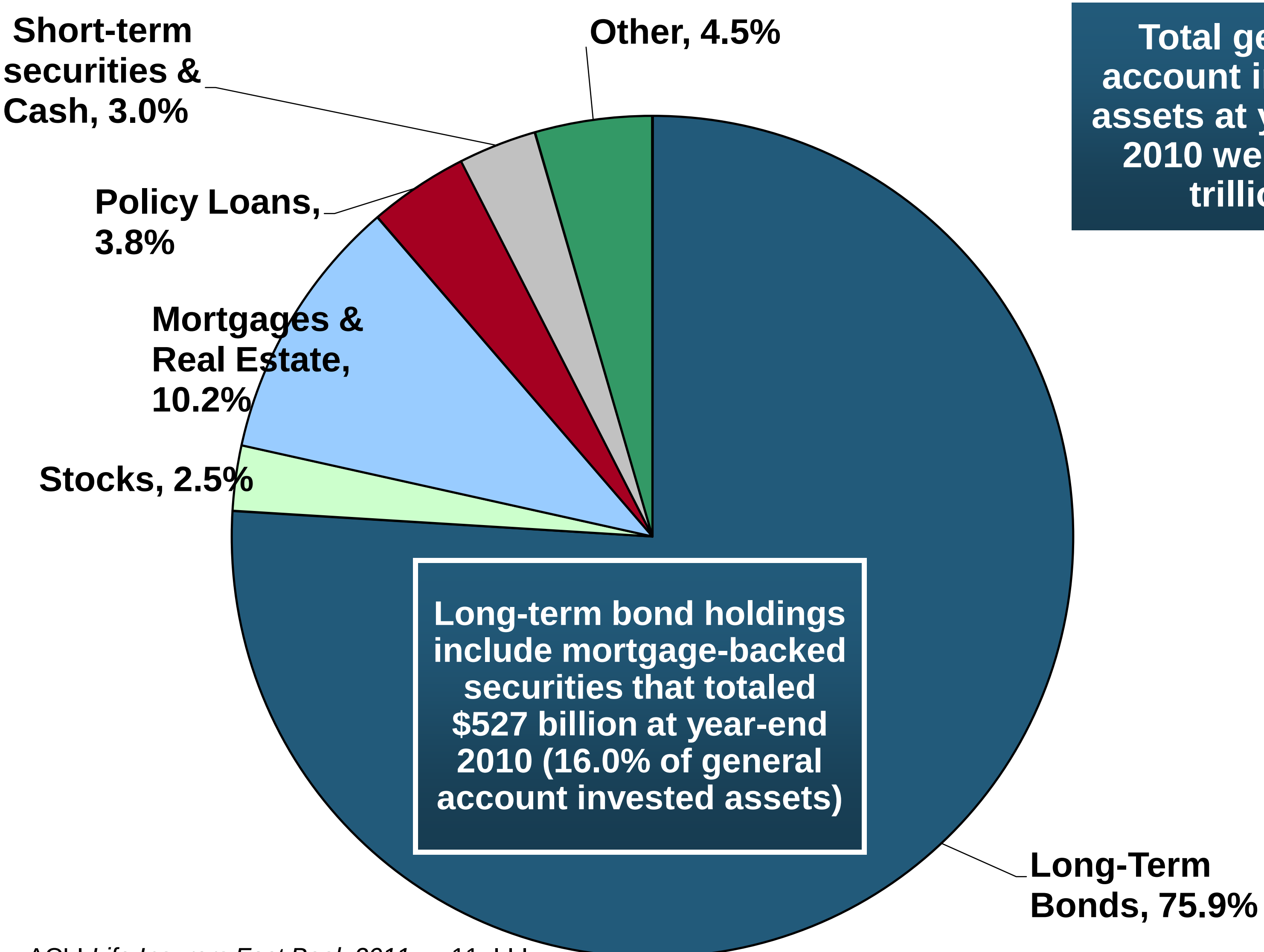
Distribution of Property/Casualty Insurer Invested Assets, 2010



Sources: Insurance Information Institute, *2012 Insurance Fact Book*, via SNL Financial.

Exhibit 6

Distribution of L/A Insurer Invested Assets (General Account), 2010

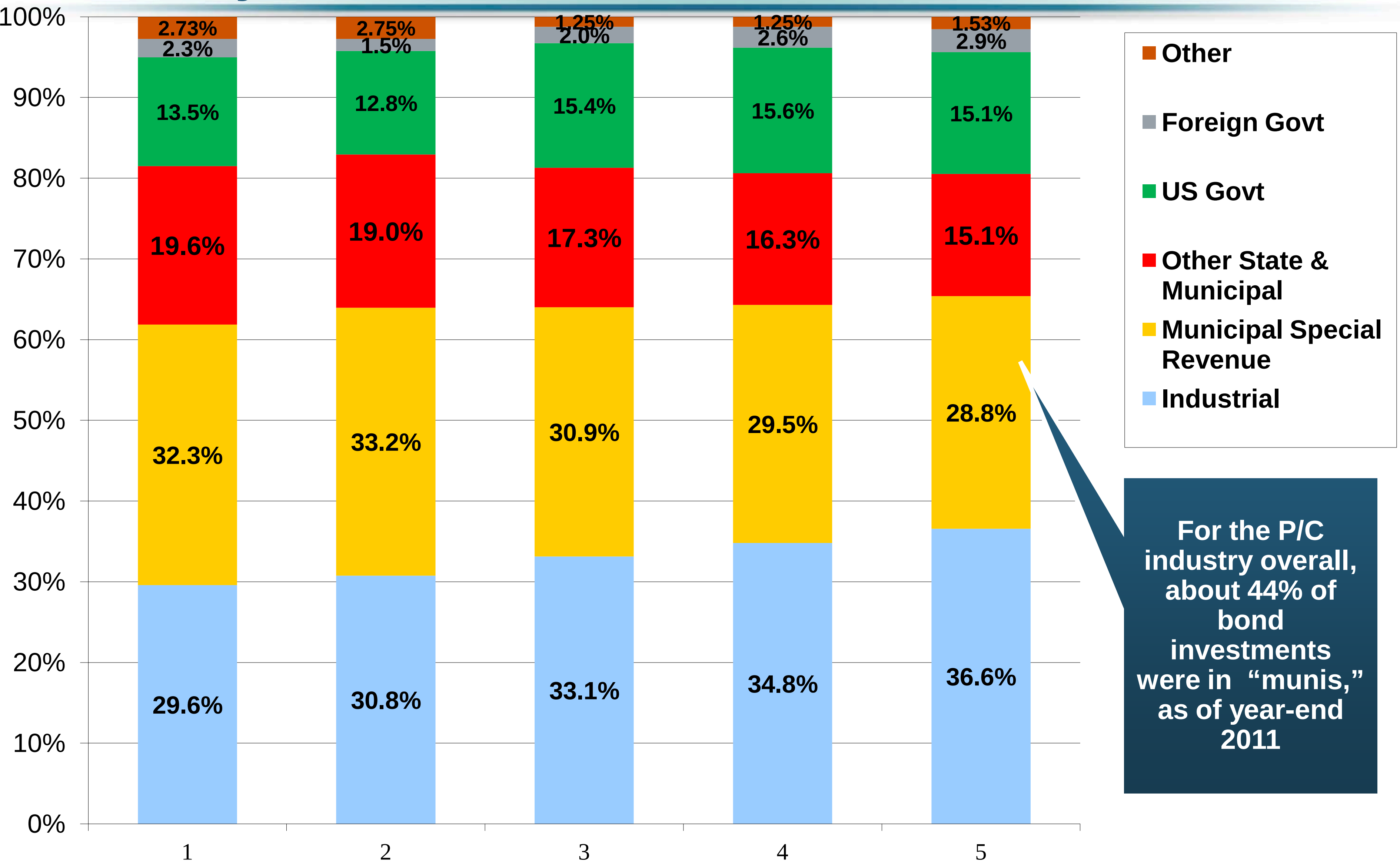


Total general account invested assets at year-end 2010 were $3.3 trillion.

Sources: ACLI *Life Insurers Fact Book 2011*, p. 11; I.I.I.

Exhibit 7

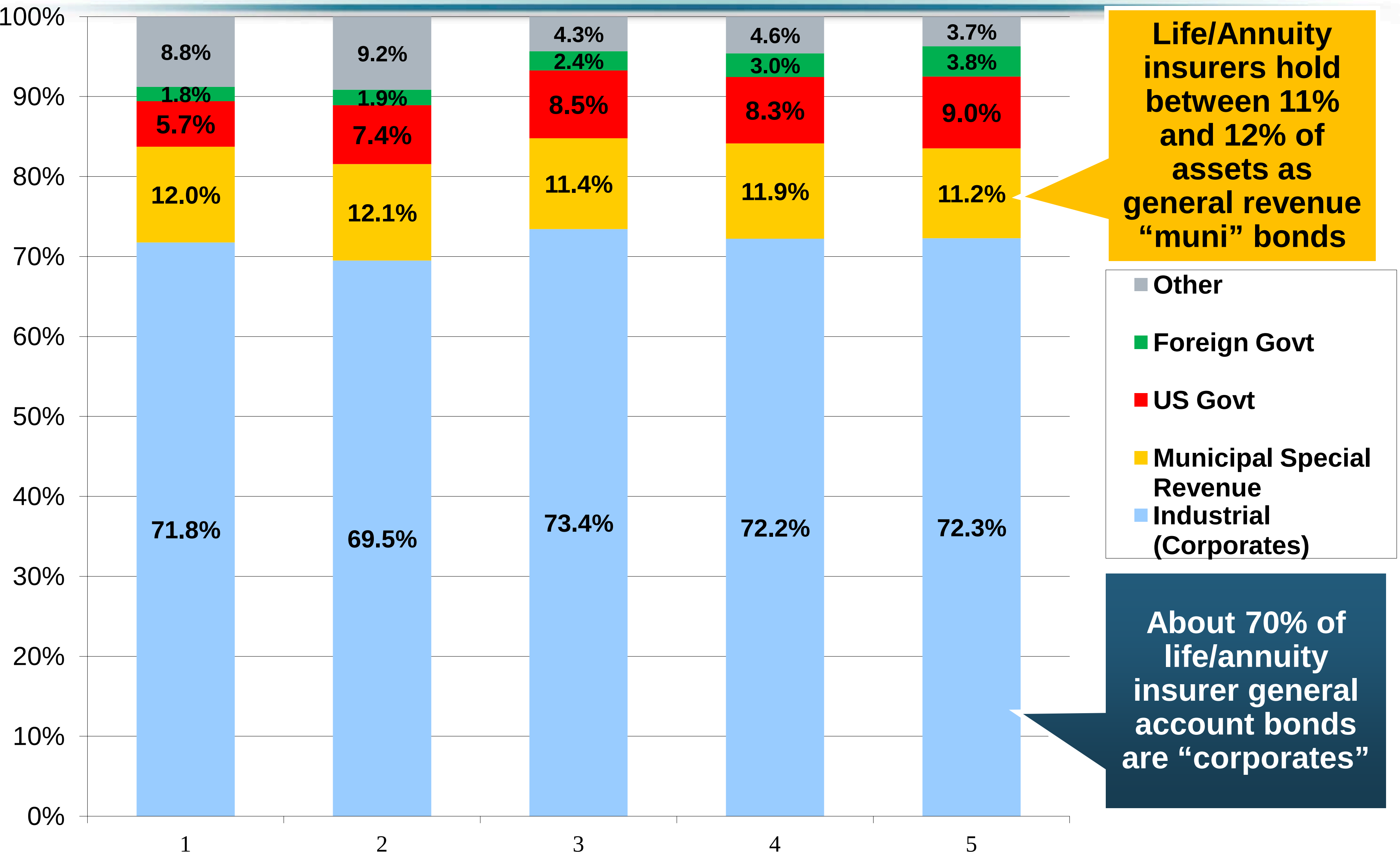
Composition of Bond Segment of Property/ Casualty Insurer Investments, 2007-2011



Sources: NAIC, via SNL Financial; I.I.I.

Exhibit 8

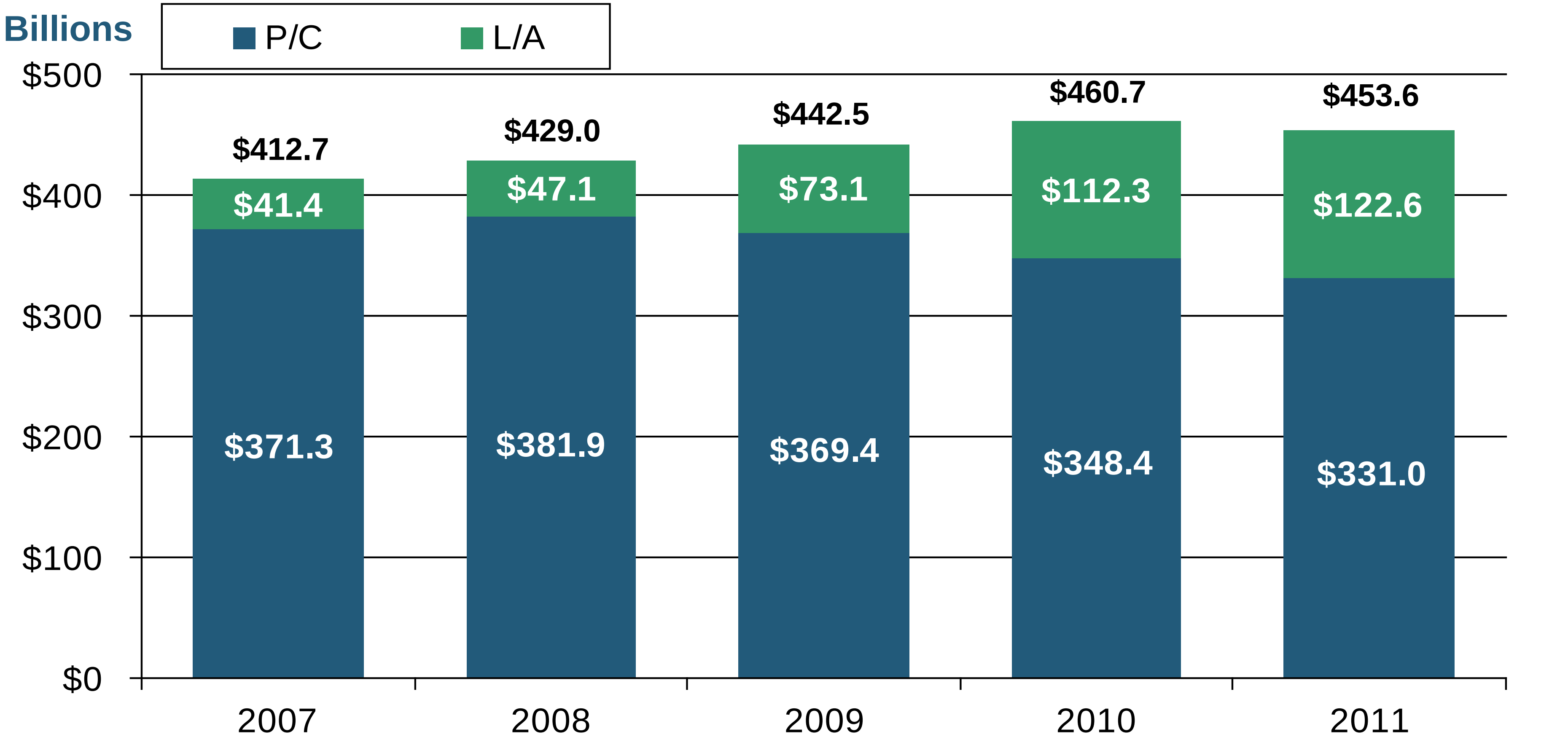
Composition of Bond Segment of Life/Annuity Insurer General Accounts, 2007-2011



Sources: NAIC, via SNL Financial; I.I.I.

Exhibit 9

Insurance Industry Municipal Bonds, 2007-2011



The insurance industry has held 12% of all municipal bonds before, during, and after the "Great Recession" (December 2007-June 2009), although there has been a shift among subsectors. Although the P/C industry trimmed its muni holdings, the L/A sector tripled its muni holdings from 2007 through 2011.

Sources: NAIC Annual Statements, via SNL Financial; Insurance Information Institute.

Exhibit 10

Overview of Insurance Sector Employment Changes*

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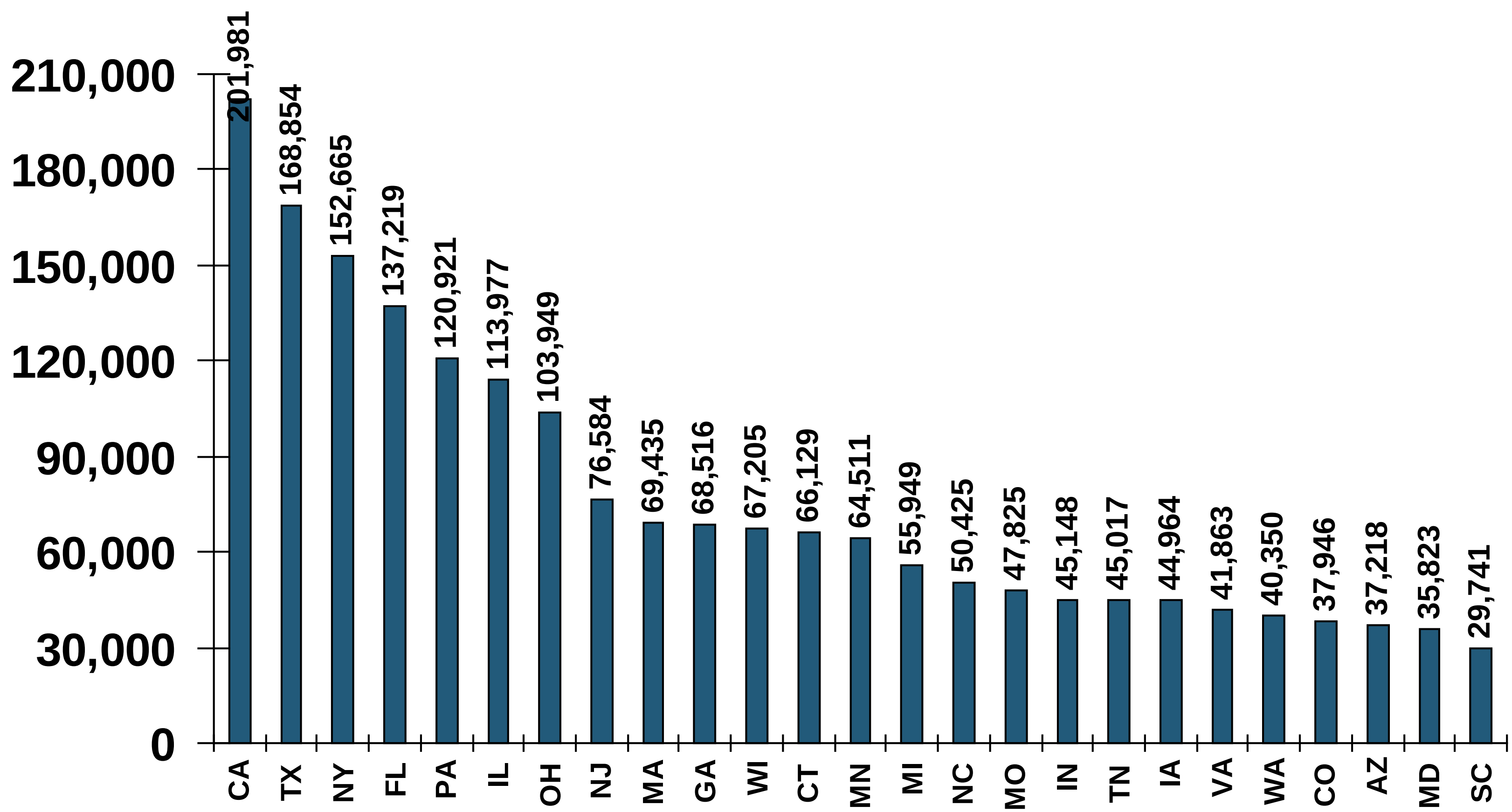
Insurance Subsector	April 2012 Employment	May 2012 Employment	Change
Property-Casualty Direct	526,300	527,900	+1,600
Reinsurers	27,800	27,700	-100
Claims Adjusters	48,200	48,200	+0
Agents/Brokers	649,700	652,900	+3,200
Life Direct	336,300	336,400	+100
Health/Medical Direct	428,400	428,500	+100
Title & other Direct	70,600	70,900	+300
3rd-Party Administration	137,400	137,300	-100
All other insurance-related activities	53,500	54,400	+900
Net Total	2,278,200	2,284,200	+6,000

*Data are through May 2012 and are preliminary (i.e., subject to later revision); not seasonally adjusted.

Exhibit 11, Page 1

Insurance Carriers And Related Activities Employment By State, 2010: Highest 25 States (1)



(1) The estimates for Alaska and Wyoming are not shown to avoid disclosure of confidential information..

Note: Does not match data shown elsewhere due to the use of different surveys. Data as of September, 2011, based on revised estimates for 2008-2010.

Source: Regional Economic Information System, Bureau of Economic Analysis, U.S. Department of Commerce.

Insurance Carriers And Related Activities Employment By State, 2010: Lowest 24 States (1)

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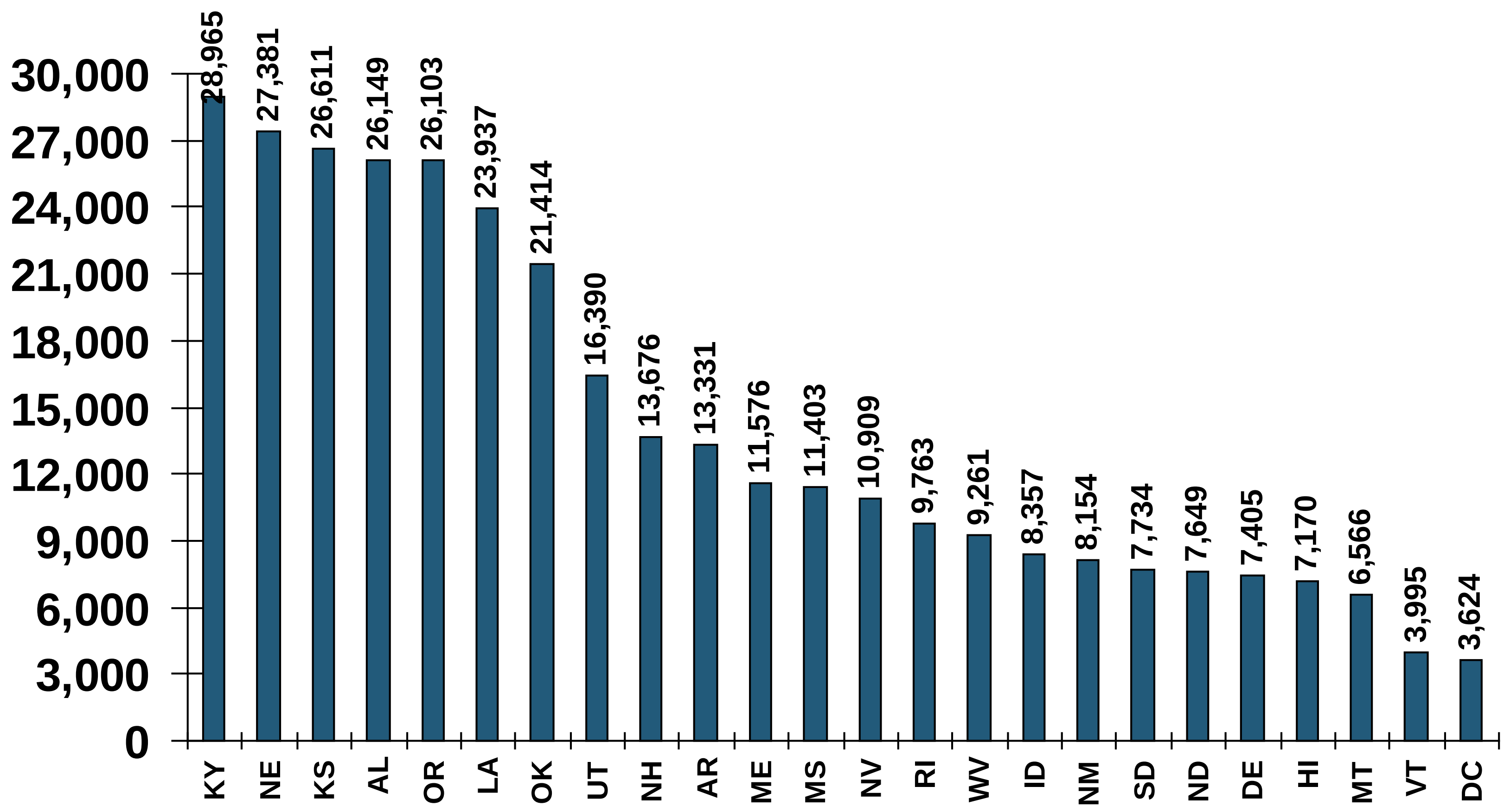

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Source: Regional Economic Information System, Bureau of Economic Analysis, U.S. Department of Commerce.

Insurance Carriers and Related Activities Compensation by State, 2010: Highest 25 States (1)

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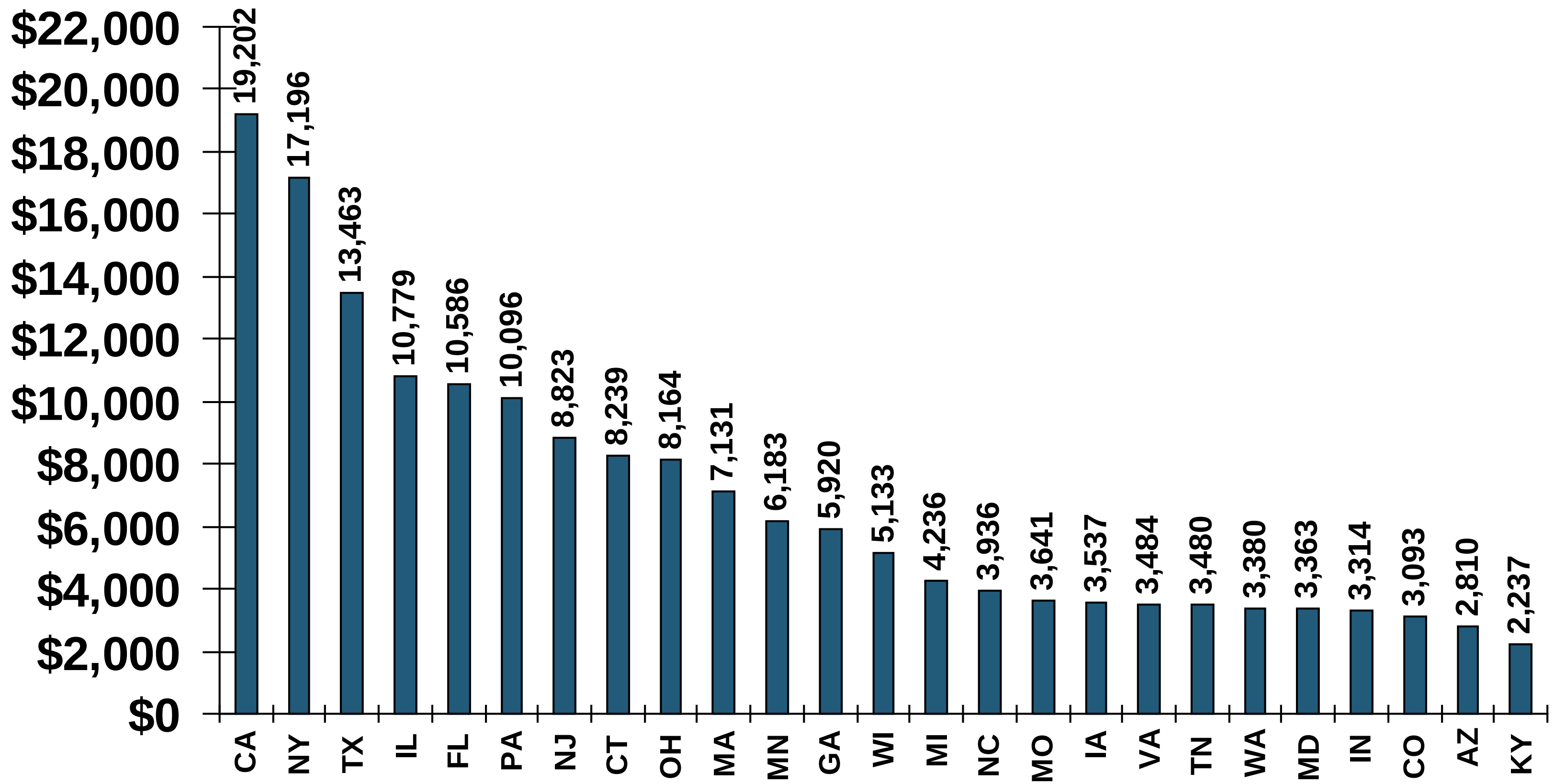
($ Millions)



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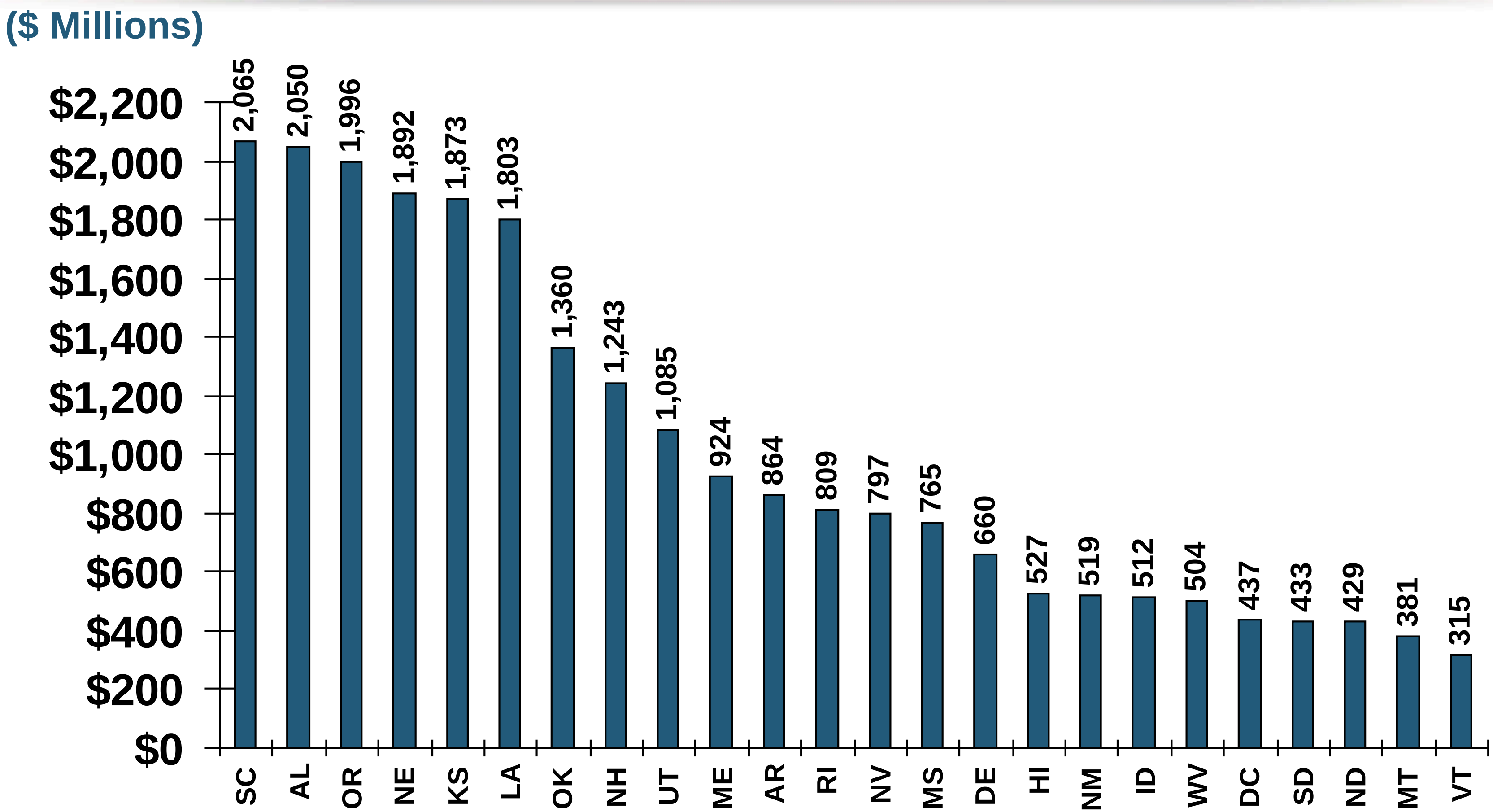

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