Testimony of

Michael F. Consedine

Commissioner

Pennsylvania Insurance Department

On Behalf of the National Association of Insurance Commissioners

Before the

Subcommittee on Housing and Insurance

Committee on Financial Services

United States House of Representatives

Regarding:

The Impact of International Regulatory Standards on the Competitiveness of U.S. Insurers

November 18, 2014

Introductory Remarks

Chairman Neugebauer, Ranking Member Capuano, and members of the Committee, thank you for the opportunity to testify today. My name is Michael Consedine. I serve as the Commissioner of the Insurance Department for the Commonwealth of Pennsylvania and I am also here on behalf of the National Association of Insurance Commissioners (NAIC).

It is truly my good fortune to lead an outstanding team in Pennsylvania of more than 200 regulators in overseeing one of the largest insurance industries in the U.S., with over $95 billion in written premium and deposits. I also serve as the NAIC's Vice-President, and Chair of the NAIC's International Insurance Relations (G) Committee.

On behalf of my fellow state insurance regulators, I appreciate the opportunity to offer our views and perspective today on the international regulatory standards being proposed by the Financial Stability Board (FSB), the International Association of Insurance Supervisor (IAIS), and other international bodies.

The NAIC and the States have an Important Role in International Insurance Matters

The NAIC and its members have long been committed to providing leadership on a wide range of global insurance issues and activities, with a focus on ensuring policyholder protections and maintaining stable and competitive insurance markets. The NAIC was a founding member of the IAIS as an international standard setter, and provided it with start-up resources more than 20 years ago, recognizing that while insurance is local product, it is a global business. For over two decades, U.S state insurance regulators have been and remain extensively engaged with our international counterparts in developing the elements of a stronger international insurance regulatory framework. Our focus has been and continues to be to ensure that such standards are adaptable to our markets and benefit our consumers.

The relevance of international standards and multijurisdictional cooperation within the U.S. have been elevated since the 2008 financial crisis. International developments at the FSB and IAIS are not binding at the state or federal level, but serve as guidance for regulators to ensure a degree of consistency in approach, if not necessarily in structure or execution. To the extent that these standards collectively elevate the quality of insurance regulation around the globe, it is a positive thing for U.S. insurers who seek to do business abroad, and for U.S. consumers who benefit from the products and competition offered by foreign participation in our market. But equally important, the development of international standards must be flexible enough to deal with structural and legal differences that exist to avoid putting insurers, and by extension consumers, at a disadvantage in one market relative to another.

Where the Federal Reserve and Treasury Department engage at the IAIS, we are committed to collaborating and sharing our perspective with them, recognizing that we each have important, yet separate and distinct responsibilities. We also respect that it is for each party to contribute to and commit to international standards to the extent they feel appropriate and to the extent they have authority to do so.

The U.S. Market Represents a Major Portion of the Global Insurance Market

U.S. insurance consumers benefit from some of the largest and most competitive insurance markets in the world with $1.8 trillion in premium volume and thousands of insurers writing policies. State insurance regulators supervise nearly a third of all global premium, and even taken individually, U.S. states make up more than 24 of the world's 50 largest insurance markets. My home state of Pennsylvania, for example, is the 14th largest insurance jurisdiction worldwide by premium volume. Our domestic insurance industry employs over 117,000 individuals that contribute over $20 billion to Pennsylvania's GDP.

The U.S. is viewed by foreign insurers as an attractive market in which to do business. This increase in competition and capacity has been good for consumers, and it has also necessitated a long history of extensive coordination with foreign supervisors. In addition to direct exchanges of information and data, state regulators have convened and led supervisory colleges (gatherings of all key regulators regardless of sector or jurisdiction) for all U.S.-based internationally active insurance groups. We have also participated in colleges hosted by foreign regulators for firms of mutual interest. This extensive interaction also informs our work. State regulators, through the NAIC, continue to take international and regional developments into account as we make enhancements to our own regulatory system through ongoing efforts like the NAIC's Solvency Modernization Initiative. We have taken great strides to enhance our group supervision framework, implement enterprise risk management reporting, improve corporate governance, and reduce collateral requirements for foreign reinsurers. All of this work has been influenced by our direct and sustained interactions with foreign regulators and standard setters. But as we consider these changes, and review international standards, we are always mindful to balance the cost with the benefit, and careful to avoid undermining a solvency system that has served policyholders, the financial system, and the economy at large extremely well.

Transparency is a Key Element of Effective Regulation

When it comes to global collaboration on insurance oversight, the IAIS is a forum intended to build consensus around best practices, much like the role of the NAIC here at home. As the largest member of the IAIS by far, the NAIC and state insurance commissioners remain committed to that important mission.

However, it is difficult to achieve optimum regulatory outcomes or reach broad consensus around international standards without the input of those most impacted, in particular the consumers we protect and the industry we regulate. That is why state regulators vigorously opposed efforts at the IAIS to limit stakeholder engagement, and why we remain committed to transparent processes here at home. The NAIC has long provided forums for significant engagement by insurance consumers, industry representatives, and other stakeholders, while preserving a capacity for regulators to meet confidentially on sensitive regulatory matters. In fact, as we sit here today, my colleagues are holding public meetings and engaging stakeholders here in D.C. to discuss a variety of issues and initiatives being undertaken by the states, including our work at the IAIS and consideration of regulatory enhancements to our state-based system.

We have provided funding for consumer representatives to participate directly in the work of the NAIC, as well as at the IAIS. We also supported expanding participation at the IAIS to include

Roy Woodall, the Financial Stability Oversight Council's voting insurance expert, and helped develop the IAIS by-law change necessary to add the Federal Insurance Office to the IAIS membership. This history of inclusiveness has benefited our work, and we believe improved the quality of IAIS's work as well. Transparency does not require that regulators hand over the power of the pen to those we regulate but simply requires that the process of standard setting be done in an open and inclusive forum. This is a fundamental aspect of our democratic system in the United States. Therefore, the IAIS's recent decision to limit direct stakeholder participation is a step back for the openness and transparency necessary to give IAIS work credibility and legitimacy, particularly if and when legislative bodies are expected to consider IAIS proposals.

Global Capital Standards for Insurers Should be Compatible with the U.S. System

Let me turn now to specific standards under discussion at the IAIS. The IAIS is simultaneously developing three new capital standards targeted for different purposes. As part of the policy measures recommended for application to globally systemically important insurers (G-SIIs), the IAIS has moved rapidly, under specific direction and pressure from the FSB, to develop international standards for a basic capital requirement (BCR) and higher loss absorbency (HLA) capital measures (capital buffers). In addition, the IAIS is developing a risk-based global insurance capital standard (ICS) as part of a Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame).

State regulators have concerns with the rapid pace of the work, and it is unclear what benefit these standards will bring to U.S. policyholders. However, the IAIS is moving forward. State insurance regulators therefore have an obligation to be at the table on behalf of our consumers and markets to seek an outcome that works for our system, should we choose to implement it. The NAIC's objective is to ensure that the capital proposals developed at the IAIS are reasonable and compatible with our system. We must also ensure they don't inadvertently lead to unintended consequences such as limiting insurance products or stagnating growth in the insurance sector, including jobs and innovation. If tailored for our regulatory system, there is value in understanding the capital adequacy of insurance groups, particularly when part of a larger conglomerate or affiliated with other entities. But that value only exists if it wraps around our existing legal entity standards. We also remain concerned with the more volatile market valuation accounting approach favored by Europe as an international standard because it represents a short-term focus rather than a longer-term view and could have a negative impact on the U.S. market to the detriment of American insurance consumers.

In our view, taking a more homogenous regulatory approach that treats insurers more like banks may actually encourage new risk-taking in the insurance industry. The NAIC is also concerned that if new standards are excessive or too inflexible, then they could increase costs on U.S. insurers and consumers and undermine the U.S. state-based insurance regulatory system, which is based on protecting policyholders and has a strong track record of effective solvency supervision and stable, competitive insurance markets. The IAIS must recognize that a system that has existing safeguards and controls to supervise the movement of capital within a group may take a different approach to capital adequacy at the group level than jurisdictions that do not have similar requirements.

We are committed to collaborating where we can, and the NAIC has long-standing procedures and ongoing responsibilities to seek input from policyholders and other interested parties, and we will continue working on these issues in a transparent manner through our NAIC process. The NAIC ComFrame Development and Analysis (G) Working Group (CDAWG) has met several times to discuss these issues, most recently on Sunday, November 16, and further meetings are planned. We also have participated in ongoing discussion with our federal colleagues at the Federal Reserve and the Federal Insurance Office. The IAIS objectives on capital standards are not easily achievable and will require a significant commitment of resources over many years to ensure that they are compatible with the U.S. system of insurance regulation.

A Global Framework for Insurance Group Supervision Should Include the U.S. System

As I mentioned earlier, the IAIS has been working for several years to develop a Common Framework (ComFrame) to enhance the cross-border supervision of Internationally Active Insurance Groups (IAIGs). ComFrame was intended to build on the foundation established by the IAIS Insurance Core Principles (ICPs), which were revised in 2011 and form the basis of best practices recommended for use by supervisors around the world. The IAIS completed a three-year ComFrame development phase in 2013, and this year it commenced a four-year field-testing phase with a target adoption date of 2018 and implementation date of 2019.

At the IAIS, the focus of the NAIC's efforts at every step has been to emphasize cooperation in supervisory practices while avoiding overly prescriptive measures, extra layers of unnecessary regulation, or new one-size-fits-all requirements for insurers who operate globally. ComFrame should promote a flexible collaborative process to achieve shared regulatory objectives and more consistent outcomes, rather than a top-down approach to group supervision that could undermine the strengths of our system. The NAIC remains concerned about the potential direction of ComFrame and will continue to evaluate the proposal to determine the extent to which its provisions might be compatible with the regulatory system here in the U.S.

The EU-U.S. Insurance Project Has Potential to Enhance Transatlantic Insurance Markets

Building on a regular series of transatlantic insurance dialogues over the past decade, the EU-U.S. Insurance Project was initiated in 2012 by the FIO, the NAIC, the European Commission, and the European Insurance and Occupational Pensions Authority. The original purpose of the project was to develop a deeper understanding of our different approaches to solvency oversight and explore ways to increase cooperation and collaboration where possible.

In December of 2012, the U.S. and EU teams issued a joint report along with a Way Forward document outlining common objectives and initiatives to be pursued over the next five years on various aspects of transatlantic group supervision such as ways to enhance the effectiveness of international supervisory colleges. In December of 2013, a joint EU-U.S. public forum was convened on international insurance group supervision and supervisory colleges in conjunction with the NAIC Fall National Meeting in Washington D.C. The Way Forward initiative was updated in July of 2014, based on recent developments and progress achieved to advance mutual understanding and recognition. Another public forum on group supervision was held in October 2014 in conjunction with the IAIS Annual General Meeting in Amsterdam.

While there has been progress toward achieving a better mutual understanding of the regulatory tools and approaches used by the U.S. and Europe, there are still many questions going forward about how the EU will treat U.S. firms under its new Solvency II oversight regime when it becomes effective in 2016. In addition, questions remain about the rationale for pursuing collateral reduction through the Treasury's Covered Agreement authority and, depending on its scope and content, what might its potential pre-emptive impact be on U.S. consumers and companies. In the meantime, U.S. state insurance regulators continue to achieve progress with enhancements to our system, including reductions in collateral requirements for foreign reinsurers that are on track to address nearly 80% of the U.S. insurance market by the end of 2015.

Conclusion

As international standard setting continues, the NAIC will remain directly engaged to determine whether the concepts under discussion at the FSB and IAIS make sense and add real benefit for U.S. policyholders. We are committed to collaborating with our federal colleagues where appropriate, and sharing our views with Congress on these important issues. NAIC is pleased to work closely with this committee to ensure that the long-standing strengths of our state-based system are preserved, that U.S. policyholders remain well protected, and that insurance markets remain stable and competitive.

Again, thank you for the opportunity to testify today.