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I am an associate professor of legal studies and business ethics at the Wharton School. I study financial regulation and, in particular, international financial regulation, a field of growing importance and one that has already transformed the way that banks and capital markets are regulated. It is a field of increasing importance to insurance as well.

1. Overview

In my testimony today on international cooperation on insurance standards, I would like to focus on three points.

The first is that international financial regulatory standards protect American consumers and American financial stability in two ways. International standards create a level playing field for financial market participants when they expand their businesses abroad and can also prevent disruptive financial contagion that starts elsewhere from affecting the American marketplace. Until recently, international insurance regulation was a relatively quiet field. But in the wake of the financial crisis, that has changed, and we should generally welcome the new vibrancy in institutions like the Financial Stability Board and the International Association of Insurance Supervisors in creating consistent capital standards and supervisory approaches for insurance companies, many of whom do business at home and abroad.

Second, it is important to remember that the United States has traditionally played a very strong role in formulating standards in matters of international regulatory cooperation, a role that would be threatened by legislation that ties the hand of its representatives. American regulators have substantially increased the degree of transparency of the international efforts to develop common capital standards for banks. They have also had a very large say in the sort of capital standards chosen. And they have set the terms of regulatory cooperation by capital markets overseers. It could hardly be otherwise given the size and strength of the American economy. On the other hand, where American regulators have not fully engaged in an international process, they may find themselves in a position where they must later accept standards that have been designed without their input – as the Securities and Exchange Commission has come perilously close to finding with regard to the development of international accounting standards. It is all but assured that representatives who represent everyone engaged with the domestic insurance industry would play a critical role in international insurance regulation given the size, strength and importance of the American insurance market. But if their ability to negotiate is curtailed, or if there are too many voices at the table, then their influence will likely be as well.

Third, while the importance of a transparent and open administrative process is undoubtedly significant, the best sort of transparency and democratic accountability is provided by legislative authorization to engage in international negotiation at the beginning of the process, followed by domestic implementation through regular administrative procedure at the end of it. No global terms will be imposed upon American insurers until American regulators adopt capital or other rules through notice and comment, on a state by state basis, subject to state administrative law. In the past, American regulators have tailored international standards to meet the needs of the American market. In my view, it is important to remember that nothing binds American consumers or market participants until American regulators come home and go through the traditional role-making process with notice and comment. Attempting to add a new set of procedural obligations on top of this to the middle of the process that begins with congressional authorization and ends with domestic notice and common rule-making would be likely both burdensome and counterproductive.

2. The Progress of International Insurance Regulatory Standards

Insurance companies were thought to be relatively safe financial intermediaries. They were regulated, especially in the United States, more to ensure that they did not deceive consumers, rather than for the risk that they would collapse and create risks for the financial system. That perspective made sense, in most contexts; insurance companies are less susceptible to bank runs or the sort of fraud-based collapses that may roil the financial and capital markets. State insurance commissioners, who are close to insurance commissioners, have traditionally led the way in this oversight.

However, the financial crisis exemplified the ways that, as insurance companies have taken on more varied responsibilities, the largest of them can threaten the stability of the system.

Most notably, this occurred in the case of the insurance giant American International Group, one of the largest companies in the country. As you all know, it collapsed in 2008. AIG provided all sorts of insurance to policyholders all over the world. But its diverse array of products proved to be its undoing; AIG was ruined by its London subsidiary, AIG Financial Products. AIG-FP wrote insufficiently hedged credit default swaps, bolstered the strong balance sheet of the larger insurance firm. As the credit crisis worsened, AIG has to post more and more collateral to satisfy its counterparties that it would make good on the credit insurance it had written. Eventually the need to post ever more collateral rendered the company insolvent. To make matters worse, AIG's securities lending business collapsed at the same time. The result was that a famously careful American insurer that served different customers across the world was undone by one relatively small London subsidiary, who, it turned out, was not being carefully overseen by British insurance regulators, the New York insurance commissioners responsible for the rest of AIG, or the Office of Thrift Supervision, which oversaw AIG to the extent that the conglomerate served as a holding company of a thrift subsidiary.

The AIG experience, and the financial crisis in general, changed the way that oversight over non-bank financial companies was allocated between the states and the federal government, particularly with regard to the effort to create international standards. Title 5 of the Dodd-Frank Wall Street Reform Act created the Federal Insurance Office within the Department of Treasury. That office has limited powers, but has been given the responsibility to "coordinate federal efforts and develop federal policy on potential aspects of international insurance matters, including representing the United States" in the International Association of Insurance Supervisors (IAIS). The FSOC accordingly has three members focused on insurance matters: the head of the FIO and a state insurance commissioner, neither of whom vote, and an independent member "having insurance expertise" who can vote.

IAIS began as a nonprofit corporation incorporated in Illinois. It was founded in 1994, in part at the urging of the Basel Committee on Banking Supervision, which began two decades earlier, and developed the first set of international capital adequacy standards for banks. The hope was that IAIS could do for insurance companies, who had become as global as any financial institution, what the Basel Committee did for banks.

IAIS's first two general meetings were held in conjunction with the annual meeting of the United States' National Association of Insurance Commissioners (NAIC). IAIS held its first annual meeting outside of the United States in 1996, in Paris. At first, IAIS represented insurance supervisory authorities in less than one hundred jurisdictions; however, by this decade, it had grown to encompass over 200 jurisdictions in about 140 countries, a base that represents at least ninety-seven percent of global insurance premiums. Since its creation, IAIS has issued global principles of insurance regulation, conducted research on supervision problems, provided training and support on issues related to insurance supervision, and organized meetings for insurance supervisors, including an Annual Conference designed "[t]o further encourage multilateral discussions on topical issues for insurance supervisors and other insurance professionals." (*About the IAIS*, INT'L ASS'N OF INS. SUPERVISORS, http://www.iaisweb.org/index.cfm?pageID=28)

In the wake of the financial crisis, IAIS, and the coordinator of financial oversight, the Financial Stability Board, under instruction from the G20, has taken new steps to create consistent global standards for supervisors designed to improve the safety and soundness of financial regulators. I will not go into these efforts in detail, but:

- The IAIS is developing capital standards for international active insurance groups. Those standards will consist of the sum of a basis capital requirement and a higher loss absorbency requirement. IAIS issued requirements on this score in October 2015.
- These capital requirements are part of ComFrame, a set of international supervisory requirement for the group-wide supervision of internationally active insurance groups.
- There has also been an effort to conclude a so-called covered agreement with the European Union. Concluding covered agreements are one of the FIO's functions,; they ae defined in Dodd-Frank as "a written bilateral or multilateral agreement regarding prudential measures with respect to the business of insurance or reinsurance that is (A) entered into between the United States and one or more foreign governments, or regulatory entities; and (B) relates to the recognition of prudential measures with respect to the business of insurance or reinsurance that achieves a level of protection for insurance or reinsurance commissioners that is substantially equivalent to the level of protection achieved under state insurance or reinsurance regulation." These agreements are meant to strengthen insurance regulation and level the playing field between for example the United Stated and European Union.

Efforts to create international insurance standards make sense as American firms increasingly enter foreign markets, and foreign firms enter the American one. Common standards level the playing field, and invite the sort of competition that can only benefit insurance consumers. And in a world where an insurance group can be destabilized by a faltering subsidiary in a single country, the value of coordinated supervision is obvious.

Nonetheless, international processes are almost by definition more difficult to follow than domestic ones. IAIS and the FSB have taken, often at the behest of American regulators, steps towards improving their transparency. They have websites, they issue consultative documents and accept comment upon them, and they hold increasingly open annual meetings. And the IAIS has usefully dropped the very high fee it required of those who hoped to attend its annual meeting. But transparency should not be viewed as requiring that any and every interested party be able to attend any meeting at any moment. No business works that way, and nor does any agency. Policymaking requires opportunities for deliberation, and the importance of a role for deliberation should not be gainsaid.

3. Finding the Right Level of Transparency for International Insurance Standards

How can we ensure that these sort of international processes have the right amount of accountability and democratic legitimacy? At best, Congress will begin the process by authorizing, or in some cases blessing, efforts at international regulatory cooperation. Second, the regulators will engage in that cooperation. And finally, regulators must come home to enact rules, following the requirements of domestic administrative procedure that would apply to internationally active insurance groups.

So far, this is the process that has been followed in the recent international insurance standards. Congress authorized American participation in Dodd-Frank. Work on the standards is now ongoing. And American regulators participating in the process have repeatedly announced that they look forward to underdoing the serious process of notice and comment here before any requirements are imposed on the American insurance market. These representations have been made before this committee, in fact.

Transparency is not helped, and substantial burdens are imposed by, imposing too many procedural requirements on the deliberation and negotiation process itself. Much of what goes on at institutions like the IAIS is a negotiation, and American representatives must have the ability to participate. That in turn means that public observer access for stakeholders to working groups and committee meetings do not make much sense. They limit the ability of negotiators to in fact negotiate – it risks creating the problems for international regulators that the well-intentioned Government in the Sunshine Act has created for domestic regulators such as the Securities and Exchange Commission, whose commissioners cannot meet privately to hash out their differences.

By the same token, requirements that proposed final agreements among international insurance regulators be published in the Federal Register is a needless layering on of notice and comment on top of notice and comment. Domestic regulators must and do bring international agreements back home for notice and comment before implementing them. And we have seen plenty of examples of cases where domestic notice and comment regularly changes the content of international agreements – the Fed's two-track implementation of the second version of the Basel capital accords is an example.

There is a little point in opening these agreements to notice and comment twice. By the same token, regular reporting on the progress of negotiations in public by the Secretary of the Treasury and the Chair of the Federal Reserve would be burdensome, only doubtfully illuminating and might make it difficult for the United States to adequately pursue its regulatory interests in these international negotiations. I teach in a business school, and I rarely see my colleagues who teach our students to negotiate advise them to regularly make public disclosures of their goals and how they think the negotiations are going.

By the same token, covered agreements are meant to strengthen insurance regulation and level the playing field between, for example, the United Stated and European Union. Requiring them to be published before they enter into force in the Federal Register simply slows the process of implementing these agreements. It also suggests that the United States might not be able to live up to its bargains, which makes these agreements – which were blessed by Congress in Dodd-Frank – all the more difficult to conclude.

Finally, legislation that would require Treasury, the Fed and the state insurance commissioners to complete an analysis of the impact on consumers and markets of any international insurance regulatory standard and open that process to notice both before drafting the report and after the draft is completed would be extremely burdensome, especially compared to the value of such a report. I am unfamiliar with other similar requirements elsewhere in administrative law. Of course the report on the impact would not be binding in any way on the agencies that draft it, even if it cast some doubt on the value of the impact of international standards.

Finally, adding to the responsibilities of the independent member needlessly adds difficulties into the negotiated relationship for insurance regulators who already have enough problems coordinating the interests of the various agencies interested in insurance regulation including the fed and the treasury department. The federal government already has two representatives at IAIS, and the state insurance commissioners, of course, have always been involved in that organization. Adding a third federal representative to the group looks superfluous, and makes the coordination process all the more difficult. It could confuse the other members of IAIS and undermine our ability to influence the process. As for the proposal that any state insurance commissioner be permitted to attend FSOC meetings when interested, it is difficult to see how that adds value, given that a state insurance commissioner already attends meetings of the council as a non-voting member. If every state commissioner attended, they would vastly outnumber everyone else in the room.

4. The Risks Of Non-Participation: The International Accounting Standards Saga

In my testimony, I have emphasized that international regulatory cooperation provides opportunities for American regulators to improve the stability of the financial system at home, and abroad, and therefore better meet their domestic regulatory mandates. I'd like to conclude with a cautionary tale about what can happen if American regulators ignore an international process, or approach it in a disorganized fashion.

The accounting story is particularly instructive. It is a cautionary tale for Americans because American regulators, by abandoning an already ongoing harmonization effort in the 1990s, lost their ability to affect the effort, and now have had to begin the process of conforming to it.

International accounting standards--the idea that companies listed on stock exchanges from Stockholm to Shanghai might report their results in the same way--have always been an attractive regulatory goal. In the 1980s, capital market regulators agreed to endorse an effort by professional accounting organizations to try for global harmonization of accounting rules. But the effort proved controversial, as American regulators comfortable with the unique American approach to financial statements withdrew their support for the enterprise in the early 1990s.

That exit, however, did not stop the process of devising common accounting standards. Instead, the international efforts moved to Europe; the creation of international accounting standards after the SEC's rejection of the prospect of them, has been managed by the International Accounting Standards Board (IASB), a public-private arrangement based in London created in 2001. The IASB has devised a set of accounting standards, the International Financial Reporting Standards (IFRS), which has enjoyed quick adoption in European and other countries. IFRS was essentially created without American participation.

And therefore, perhaps unsurprisingly, IFRS is rather different from American accounting rules. It is a principles--rather than rules--based accounting system, in that it is less technical than traditional American accounting, and relies more on the gestalt of a company's returns to assess its accuracy. The United States had--and, for the moment, still has--a unique rules-based and reputedly challenging set of accounting standards that differ greatly from those of any other nation, the Generally Accepted Accounting Principles (GAAP).

But, faced with a cascade of adoptions of IFRS, those GAAP principles have a very tenuous future, despite the SEC's doubling down on their necessity in the 1990s. As foreign jurisdictions have gained more and more of the business of floating stocks and bonds and raising capital, American capital market regulators have given up hope that they might do so in ways consistent with the complicated GAAP. The SEC has permitted foreign companies that list on American stock markets to use IFRS to file their American annual and quarterly reports. And the SEC will surely accede to IFRS eventually for all filers.

Accounting is technical, and acronyms like GAAP and IFRS daunt almost as much as they reveal what, exactly, the distinction between rules-based and principles-based accounting really amounts to. But the import of the triumph of IFRS can be gleaned by abstracting away from it, and from the details of accounting. The commitment to an international effort in accounting has worked a sea change in the way that companies report their results, and the sea change has come without much American involvement--even though it will, in the near future, affect American companies as much as anyone else.

Thus, this story of accounting standards illustrates what those who worry what happens when regulators meet in a room have always suspected. Regulatory cooperation is easy to institutionalize--even when it crosses borders. Its propensity towards momentum is not a universal law, to be sure, but regulators ignore cross-border efforts at their peril, because those efforts can set the standards for even the most independent and recalcitrant jurisdictions, if the circumstances are right.

Thank you.