THE IMPACT OF DODD-FRANK'S INSURANCE REGULATIONS ON CONSUMERS, JOB CREATORS, AND THE ECONOMY

HEARING

BEFORE THE

SUBCOMMITTEE ON
INSURANCE, HOUSING AND
COMMUNITY OPPORTUNITY

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

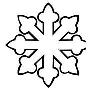
ONE HUNDRED TWELFTH CONGRESS

SECOND SESSION

JULY 24, 2012

Printed for the use of the Committee on Financial Services

Serial No. 112–150



U.S. GOVERNMENT PRINTING OFFICE

76–121 PDF WASHINGTON : 2012

For sale by the Superintendent of Documents, U.S. Government Printing Office
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THE IMPACT OF DODD-FRANK'S INSURANCE REGULATIONS ON CONSUMERS, JOB CREATORS, AND THE ECONOMY

Tuesday, July 24, 2012

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

The subcommittee met, pursuant to notice, at 2 p.m., in room 2128, Rayburn House Office Building, Hon. Judy Biggert [chairwoman of the subcommittee] presiding.

Members present: Representatives Biggert, Hurt, Miller of California, McHenry, Dold; Gutierrez, Velazquez, and Sherman.

Chairwoman BIGGERT. This hearing of the Subcommittee on Insurance, Housing and Community Opportunity will come to order.

We will start with the opening statements. And without objection, all Members' opening statements will be made a part of the record.

And I will now recognize myself for an opening statement.

Good afternoon, everyone, and welcome to today's hearing. I welcome today's witnesses, including our colleague, Mr. Posey of Florida, who is our only witness on Panel I.

This is the fifth subcommittee hearing on regulatory developments, domestic and international, that have created uncertainty for the insurance sector. The subcommittee continues to explore the extent to which this regulatory uncertainty could result in higher prices and fewer insurance products for consumers, increased costs and foregone opportunities for businesses, and reduced economic growth, leading to fewer jobs.

During these hearings, we heard about a number of Dodd-Frank-Act-related matters of concern to life and property/casualty insurance companies of all sizes from across the country—businesses that had nothing to do with the financial crisis.

In November, the subcommittee examined three discussion draft legislation proposals to amend the Dodd-Frank Act. The first draft addressed the authority of FIO and OFR to collect insurance data and maintain its confidentiality, which is now H.R. 3559, the Insurance Data Protection Act, introduced by Mr. Stivers. The second draft would exempt insurers from FDIC's Orderly Liquidation Authority, OLA, and Orderly Liquidation Fund, OLF, a bill Mr. Posey is perfecting. The third draft would limit the Federal Reserve's au-

thority to regulate insurance or subject insurance companies to heightened prudential standards, including additional capital requirements.

The good news is that the Federal bank regulators—the FDIC, Treasury officials, and last week, Federal Reserve Chairman Bernanke—have signaled that they do not intend to apply bank-centric regulations to insurance. Federal bank regulators also have signaled that the insurance regulation should be left up to the States, which, as I have noted many times, the State-based regulatory system for insurance has worked well for over 150 years.

I am afraid the same can't be said for banking regulation. Unfortunately, uncertainty remains, and proposed regulations by these same regulators don't reflect specific considerations for insurance. Congress and insurers are still uncertain if, for example, the Federal Reserve will impose bank-like capital standards on insurance companies that are part of a savings and loan or a thrift holding company.

Today's hearing, entitled, "The Impact of Dodd-Frank's Insurance Regulations on Consumers, Job Creators, and the Economy," is part of the committee's continued oversight hearings around the second anniversary of the Dodd-Frank Act. We will explore the consequences for insurance companies, consumers, job creators, and the economy of unnecessary increased compliance costs as well as limitations on investments due to Dodd-Frank.

Why does Dodd-Frank's impact on insurance matter to families, businesses, and our economy? Why should everyday insurance consumers, workers, municipalities, and other job creators and charities be concerned? Specifically, this hearing will attempt to answer those questions and evaluate the effect on insurance companies and their customers of the new Dodd-Frank regulations.

It is important that we get the regulation of insurance right. In Illinois, property and casualty insurers have written over $2.2 billion in premiums, life insurers have written almost $26 billion in insurance premiums or annuities, and 114,000 workers are employed by the insurance sector.

It is important that Congress prevent the unnecessary layering of new Dodd-Frank regulations and costs on insurers. We must get it right for direct and indirect beneficiaries of insurance: families and businesses of all kinds and sizes; cities and towns; and workers with jobs in Illinois and across the country. Our economy, business, and families cannot afford additional job losses, increased costs for products, reduced private-sector investments, or reduced benefits.

With that, I welcome input from all of the Members on this discussion draft, and I yield to the ranking member of the subcommittee, Ranking Member Gutierrez, for his opening statement.

Mr. GUTIERREZ. Thank you for yielding, Madam Chairwoman.

Recent developments such as JPMorgan Chase—they asked me for two IDs the last time I went to JPMorgan Chase. I said, "You should be more careful with the billions of dollars you trade than with the couple hundred dollars extra I want." At JPMorgan Chase, they are so silly, they ask their customers—you want to talk about—no, it really is. Because they said, "Hey, Congressman Gutierrez, how are you today? Do you have another ID?" I said, "No, I don't. Do you have the $5 billion? Or is it up to $7 billion?"

This kind of attests to the fact that it is a good thing we have Frank-Dodd, because they are still losing billions of dollars as I go out there.

And so I know this is going to be a wonderful hearing. But I haven't had any problem; I call up my State Farm agent, and he is still there—Tom Rafferty in Hinsdale, Illinois. I think you probably represent him in the Congress. He is still there writing out insurance policies and hoping that Luis Gutierrez and his family don't have any car accidents or trees don't fall on his home. It doesn't seem like there has been a problem.

But I will tell you, we should remember three simple letters when we want—because we all know that the Federal Government really doesn't cover insurance companies. And there are three letters: AIG. So before we start saying, oh, those poor insurance companies, and we really shouldn't be messing with them and putting any layers of—how is it—regulations, they don't need to be watched, let's just remember three letters, not "ABC," "AIG." And thanks to the Federal Government, of course, those of us here had to go and bail them out and make sure that they stayed afloat because they are important to our economy.

So before we start talking about—it is like it doesn't end. I turned on CNN, and there was this big bank out there and the CEO getting thrown out because they were lying about the LIBOR. And they keep telling us we don't need any regulations. Really? And we haven't even really gotten to the bottom of the LIBOR scandal and what it is that banks do.

I have to tell you, I won't mention, but if you want, you can probably go check my—what is it—those forms we fill out every year and we make sure—the financial disclosure forms. You see, I check with Chuck every day, because I want to make sure he didn't take a vacation with my money. Not that he would, but I just want to check. And I think most people in America check, and they should, because there are still people out there—and you can ask them—who are losing money because they put their money into what are supposedly safe accounts, only to see the money disappear.

So to kind of suggest at this particular point that somehow it is all over, everything is great, and that the financial industry is going to do everything on the up and up, all we have to do is read the papers from the last month to realize that it really is an industry that needs us to continue to watch over them in defense of the consumers. And I know that is sometimes an ugly word, because every time we bring up making sure that the consumers are well-protected here in the Congress of the United States, they say that we are people who are stopping the growth of our economy.

I am just going to end with this. I won't take up all of the time. But I remember when I sat here in 2008 as our economy became unraveled. You want to talk about losing jobs? We lost millions upon millions upon millions of jobs between 2007 and 2008, millions and millions, sometimes hundreds of thousands in any given month. And for anybody to suggest that we didn't lose a lot of those jobs because of what the banking industry was doing, or not doing, and the kinds of things that they were doing in terms of even trading across seas and across the world, I think just doesn't do justice to the fact that we lost those millions of jobs.

So I also care about jobs. And if we leave them unregulated, we know that we can cause this recession to go into a depression. So let's be very mindful that there are those that need watching and that the people who sent us here to the Congress of the United States sent us here to watch out for their special and very best interests.

Thank you very much.

Chairwoman BIGGERT. Thank you.

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

Mr. MILLER OF CALIFORNIA. Thank you.

I would like to thank you, Chairwoman Biggert, for holding this hearing. It is important to our economy that the committee closely monitor the implementation of Dodd-Frank Act regulations.

While the Dodd-Frank Act supposedly exempts the insurance industry from many aspects of the law, we are hearing concerns that regulators are extending their rule to include insurance companies, where regulators do not have authority. We are hearing concerns that the rules being proposed are bank-centric and do not take into account the fundamental differences between how banks and insurance companies operate. For example, the Federal Reserve proposed rules on capital standards for savings-and-loan holding companies that are owned by insurance companies that will have major impacts on cost and availability of insurance policies for American consumers.

If the Fed rule does not recognize the difference between banks and insurance companies in its rules, the bank-centric capital standards imposed on the insurance companies will do harm to job creators in this country. Since the Federal Reserve has no experience in regulating insurance companies, the Fed needs to be extremely careful and take all the necessary steps to understand the industry before imposing rules that could have major economic consequences.

We are also hearing concerns that a proposal requiring insurers to prepare Federal financial statements using Generally Accepted Accounting Principles, also known as GAAP—while State regulators require reporting using Statutory Accounting Principles (SAP), known as SAP—will increase costs for insurance companies' compliance with regulations. Two different accounting methods to report essentially the same information in different ways is unnecessary. This only adds to the cost of doing business for insurance companies. Such costs will ultimately be borne by the consumers of insurance products.

Lastly, the Volcker Rule is clearly a major concern for the banking industry. While it was never intended to apply to insurance companies, it could have an impact on them because the regulations are failing to see the difference between banks and insurance companies. If insurance companies are swept under the Volcker Rule, the cost of insurance companies' ability to hedge risk will be increased. In addition, the Volcker Rule could prohibit insurance companies from playing the traditional role in debt and equity markets. Congress exempted insurance companies in the statute, and regulators needs to follow Congress' intent.

In closing, while the regulators aren't here today, this hearing is important for us to hear about the impact of these overreaching regulations on the insurance industry and, ultimately, on our economy. I look forward to hearing the testimony today. Hopefully, it will be insightful and we can move forward.

Thank you, Madam Chairwoman.

Chairwoman BIGGERT. Thank you.

The gentleman from Illinois, Mr. Dold, is recognized for 2 minutes.

Mr. DOLD. I thank the chairwoman for holding this important hearing and for recognizing me.

Efficient and sound markets obviously require different and customized rules for different industries. Fortunately, Dodd-Frank recognized the inherent differences between the banking industry and the insurance industry and tried to ensure that insurance companies don't fall under an inappropriate regulatory framework.

Title I of Dodd-Frank requires the Federal Reserve to set new capital rules for large banks and bank holding companies to prevent excess leverage and undercapitalization and the consequent stability threat. Though well-intentioned, these new risk-based capital rules also apply to insurance companies that take deposits at some level in their corporate structure, despite their fundamentally different structure and risk profile.

We need to ensure that these new rules account for the unique insurance company business model and don't create unnecessarily costly and otherwise counterproductive burdens for the U.S. insurance industry. If these rules are not customized for the insurance company business model, we can expect to see consumers damaged by higher insurance costs and diminished product availability, along with our economy damaged by fewer jobs, weakened global competitiveness, and diminished investment capital availability. And I am confident that none of us wants those negative consequences.

Another critical point is that we must examine these new regulations in their broader context. These rules aren't being introduced on a clean slate. Instead, they will be introduced on top of an elaborate, well-established, and preexisting insurance regulatory framework. And they are being introduced simultaneously with increased State regulatory scrutiny, new international requirements, and a new Federal insurance monitoring agency. So we can't consider any particular rule in isolation, but instead we must consider the aggregate effect.

The insurance industry is critical to our economy, not only because it provides millions of Americans with security from everyday risks, but also because the industry's investments in our capital markets drive growth and productivity. Insurance companies are uniquely capable of maintaining diverse long-term portfolios, promoting stable capital markets, and pooling capital for small-business growth.

I see my time has expired, Madam Chairwoman, and I yield back.

Chairwoman BIGGERT. Thank you.

We will now turn to our first panel. Let me just say that, without objection, Panel I and Panel II's statements will be made a part of the record.

And I will now turn to our first witness, Representative Bill Posey from Florida.

We are delighted to have you here. And, of course, you are usually here because you are one of the members of the Financial Services Committee. With that, you are recognized for 5 minutes.

STATEMENT OF THE HONORABLE BILL POSEY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF FLORIDA

Mr. POSEY. Thank you, Chairwoman Biggert, Ranking Member Gutierrez, and members of the subcommitee. I appreciate the opportunity to speak before the Insurance Subcommittee today.

And just before I forget, as an asterisk, I would like to just quote from the record of an October 25, 2011, subcommittee hearing. This was the Director of the Federal Insurance Office, Mr. McRaith: "The autopsy has, frankly, shown that it was not the insurers that caused the problems for AIG as a holding company." I ask unanimous consent to make it a part of the record.

Chairwoman BIGGERT. Without objection, it is so ordered.

Mr. POSEY. I devoted a great deal of time to insurance issues as a legislator in Florida, insurance of all kinds, not just the type that the weather tends to make people discuss in Florida.

Florida is a large State with many different kinds of insurance-related challenges to deal with. Last year, premiums that were written by property/casualty insurance companies alone totaled over $37 billion. Premiums on life and health insurance were over $42 billion. Premium taxes paid in Florida were over $667 million in 2010. Those are big numbers, but behind the numbers are real people, real families.

I don't know anyone who likes to pay insurance premiums, let alone higher premiums. No one likes to think about the day when they might need that policy to be there for their home, their car, or to help provide financial security after the passing of a loved one. But when insurance functions as it is supposed to, we appreciate its value to help us manage life's many risks. So it is important that we in Congress get this issue right, because it affects virtually everyone each and every one of us knows or cares about.

I have our discussion draft bill that addresses the various problems brought to our attention with the new financial regulation bill. Madam Chairwoman, I would like to submit for the record the latest draft of the bill to address the problem.

Chairwoman BIGGERT. Without objection, it is so ordered.

Mr. POSEY. Thank you.

Last November, this subcommittee held a hearing on discussion draft legislation that would exempt insurance companies from the FDIC's new Orderly Liquidation Authority and Orderly Liquidation Fund for large Wall Street institutions and those determined to be systemically important, or, as some say, too-big-to-fail.

Under Dodd-Frank, the FDIC, the traditional banking regulator and insurer of deposits, oversees the new fund for these mega financial companies. Whatever views my colleagues may have regarding bailouts—I personally oppose them—I hope we can correct

an injustice in Dodd-Frank that impacts insurance companies and our constituents.

Right now, the FDIC has the power to assess fees to create this new fund. However, in addition to assessing the big Wall Street firms, for which I personally believe the fund was intended, the FDIC can force insurance companies to pay into it. This is the case even though the insurance companies are not eligible to use the fund and they do not need the fund.

The insurance sector could be footing the bill for failed Wall Street firms. Back home, this means our constituents, your constituents, my constituents, all of our constituents, the ones who pay the premiums, could have to pay higher rates to cover risk on Wall Street. Why should our constituents pay higher rates for life or property/casualty insurance premiums for bad decisions made on Wall Street?

This bill would exempt insurance companies from paying into the liquidation fund. It is similar to a draft circulated and discussed by this subcommittee last November, but I believe it has been improved, with the help of the chairwoman and others interested in this issue.

The insurance industry did not cause the financial meltdown. As we debated Dodd-Frank, we seemed to agree that regulation of insurance was generally best left to the States. For decades, Congress has recognized that State authorities have the expertise, proximity, track record, and Federalist constitutional authority, for that matter, to regulate insurance. Insurance companies pay into State guarantee funds to deal with insolvencies.

Shaking down insurance companies for Wall Street bank failures has big economic consequences, considering the insurance sector provides millions of jobs and tens of billions in State and Federal revenue. Property/casualty and life insurance alone equaled $18 billion in 2010. Insurance companies invest in the capital markets, in the U.S. Government, and municipal, company, county, and other bond securities. We may take it for granted, but insurance helps us pay for projects like roads and schools.

In closing, forcing insurance companies to pay twice, into the State guarantee funds and into the new Orderly Liquidation Fund (OLF), could have widespread repercussions for our constituents and for the economy.

Thank you again for this opportunity to speak today. I hope we can work together on a commonsense fix to address this issue. And I would be delighted to answer any questions.

[The prepared statement of Representative Posey can be found on page 30 of the appendix.]

Chairwoman BIGGERT. Thank you, Mr. Posey.

Does anyone have any questions? No? Then, I think we will excuse you. But thank you so much for being here, and we look forward to looking at the draft legislation. Thank you.

Mr. POSEY. Thank you.

Chairwoman BIGGERT. I think we will move to Panel II so we can start with the testimony. As usual in the afternoon, we are having votes, and they are scheduled for around 2:30, but you never know whether it will go further than that. So if you can take your seats, we will get started.

Welcome, to our second panel. As was stated earlier, your testimony will be submitted for the record. And we will start with—let me go through the names: Dr. Robert Hartwig, president, Insurance Information Institute; Birny Birnbaum, executive director, Center for Economic Justice; Charles M. Chamness, president and CEO, National Association of Mutual Insurance Companies; and Thomas Quaadman, vice president, Center for Capital Markets Competitiveness, U.S. Chamber of Commerce.

Welcome to you all.

We will start with Dr. Hartwig. You are recognized for 5 minutes.

STATEMENT OF ROBERT P. HARTWIG, PH.D., PRESIDENT AND ECONOMIST, INSURANCE INFORMATION INSTITUTE

Mr. HARTWIG. Thank you, Chairwoman Biggert, Ranking Member Gutierrez, and members of the subcommittee. And 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.

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

Insurance is a financial risk management tool that allows individuals and businesses to reduce or avoid risk through the transfer of that risk to an insurance company. 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.

Because virtually any risk that can be quantified can be insured, the use of insurance has become commonplace. In 2010, worldwide combined property/casualty and life insurance premiums totaled $4.3 trillion, or about 6.9 percent of global GDP. Collectively, these premiums reflect the transfer of hundreds of trillions of dollars of risk exposure to insurance companies around the world. No modern economy could function as efficiently without the widespread use of insurance, and many activities in today's disaster-prone and highly litigious society would be impossible altogether. It is therefore critical that any and all regulations impacting the industry, including Dodd-Frank, not in any way diminish the ability of the insurer to play the key role it has played for centuries.

To get a sense of the scale of the insurance industry, in Exhibit 1 in my testimony you will see that premiums written for the P&C and life and annuity segments of the industry totaled $1.1 trillion at the end of 2010. Likewise, when we look at the industry in terms of its assets, you will see that those totaled $4.5 trillion at the end of 2010.

Now, despite difficult economic times in recent years, 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, and 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. Consequently, the 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 clearly distinct from that of the banking sector.

The insurance industry's need to maintain large holdings of assets to back claims and satisfy regulatory requirements implies that the industry is one of the largest institutional investors in the world. Exhibits 5 and 6 in my testimony show the distribution of the industry's $4.5 trillion in investments. Insurers are necessarily conservative investors and, as such, concentrate their investments in relatively low-risk, highly liquid securities, especially bonds, which account for about 70 percent of industrywide assets.

It is also worth noting that about 44 percent of the P&C insurance industry's bond portfolio is invested in municipal securities, or munies, as you will see in Exhibit 7. In other words, the property/casualty insurance industry alone in 2011 held bonds that served to finance some $331 billion in a wide array of projects financing schools, roads, bridges, water treatment plants, mass transit, healthcare facilities, you name it.

Now, as noted in Exhibit 10, the insurance industry is also an important employer, with about 2.3 million employees across the country. Exhibit 11 shows the number of people employed by insurance carriers in 2010, with 100,000 or more workers in 8 States, including the chairman's State and the ranking member's State of Illinois, and at least 50,000 per State in 8 other States. About $200 billion in wages were paid to employees during 2010, fueling local economic growth and supporting millions of secondary jobs.

Now, in terms of the concerns associated with Dodd-Frank and potentially subsequent regulations, P&C insurance, in particular, is a large and vital industry in the United States. It is also sound, stable, strong, and secure, having earned a reputation for maintaining financial strength even when claim activity is far above expectations, such as in the wake of the September 11th terrorist attacks, or Hurricane Katrina, which produced $41 billion in insured losses from claims, establishing a new record that even stands to this day.

Insurers were able to meet these challenges because of long-standing operational philosophy that gives rise to a conservative underwriting and investment model. The same philosophy allows property/casualty insurers to continue with business as usual even during steep economic downturns, including the 2008 financial crisis and the "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, including the largest failures in U.S. history.

It is important to recognize that in the decade leading up to the passage of the Dodd-Frank Act in 2010, the property/casualty insurance industry experienced the worst claim events in its history

and weathered the worse recession since the Great Depression. The industry operated throughout this period without interruption.

Finally, the evidence that—

Mr. GUTIERREZ. The time, Madam Chairwoman?

Mr. HARTWIG. Do you have a vote?

Chairwoman BIGGERT. No, but your time—

Mr. HARTWIG. I am just winding up.

Chairwoman BIGGERT. If you would wrap up, please.

Mr. HARTWIG. Right. Just 30 more seconds.

There have been a variety of concerns, including the Volcker Rule, as we have already heard a few moments ago, and particularly with respect to banks that do have associations with—insurance companies whose primary business is insurance but have associations and affiliations with banks, as well as concerns about mission creep associated with the Consumer Financial Protection Bureau, the eventual execution of subpoena authority from the Federal Insurance Office, among others, as well as the Federal Reserve's authority associated with Systemically Important Financial Institutions (SIFI).

So, again, thank you for the opportunity to testify before the subcommittee today. And I, as well, would be happy to respond to any questions.

[The prepared statement of Dr. Hartwig can be found on page 57 of the appendix.]

Chairwoman BIGGERT. Thank you.

Mr. Birnbaum, you are recognized for 5 minutes.

STATEMENT OF BIRNY BIRNBAUM, EXECUTIVE DIRECTOR, CENTER FOR ECONOMIC JUSTICE

Mr. BIRNBAUM. Thank you very much, Chairwoman Biggert, Ranking Member Gutierrez, and members of the subcommittee. Thanks for the opportunity to speak on the impact of the Dodd-Frank Act on insurance consumers, insurers, and the economy.

To evaluate the impact of Dodd-Frank on insurance consumers and insurers, it is necessary to review how the insurance industry contributed to and was impacted by the financial crisis starting in 2007. My experience and observation is that insurers did contribute to the financial crisis, and the limitations of State-based insurance regulation became apparent as the crisis unfolded. State-based insurance regulation certainly has its strengths, but the Dodd-Frank Act has assisted and strengthened State-based insurance regulation.

On the property/casualty side, we must start with the spectacular collapse of AIG, which resulted in a massive taxpayer bailout. AIG certainly contributed to the financial crisis because of its huge bets on credit default swaps. While State insurance regulators have argued it was the noninsurance subsidiaries of AIG and not AIG insurance companies which caused the collapse, the fact remains that State insurance regulators were not able to monitor AIG at the broader holding company level.

In addition, State insurance regulators missed risky investment activities by AIG involving the lending of securities. AIG loaned out securities owned by its insurance company subsidiaries. And with the proceeds from these loans, AIG invested $76 billion at its peak

in long-term subprime residential mortgage-backed securities. When the borrowers of the AIG securities returned the securities, requesting the return of their cash, AIG did not have the cash because of severe market devaluations of the residential mortgage-backed securities. The Federal Reserve stepped in to provide liquidity.

There are other types of property/casualty insurers which contributed to and were dramatically impacted by the financial crisis, including financial guaranty and mortgage insurance. Financial guaranty insurers, also known as bond insurers, mistakenly provided assurance for a variety of asset-backed securities, contributing to the sale of risky and destined-to-fail mortgage-backed securities.

After years of paying few claims in relation to premium, the bottom fell out starting in 2007. From 2007 to 2011, financial guaranty insurers incurred almost $37 billion in claims, more than 2½ times the premiums they earned during that period. The financial guaranty insurance market collapsed, and the weakness and failure of financial guaranty insurers rippled through the economy because the absence of financial guaranty insurance can create great difficulties for States and municipalities to issue debt.

The private mortgage guaranty insurance market also contributed to and was crushed by the financial crisis. Today, the Federal Housing Authority is supporting the mortgage market by providing increased amounts of mortgage insurance. As with the financial guaranty insurance, after years of very low loss ratios, mortgage insurers' poor risk management resulted in massive losses starting in 2007. The weak condition of mortgage insurer PMI caused the Arizona regulator to order it to stop writing new business last year. MGIC has only been able to continue to write new business because its State regulator waived minimum capital requirements.

Life insurance and annuities: The life insurance industry was greatly impacted by the financial crisis. Life insurers sought relief from the Federal Government in the form of TARP funds and from State regulators in the form of lower claim reserve requirements and changed accounting standards.

The problems experienced by the life insurance industry stem from the fact that life insurer products have transformed over time from mortality protection to market return protection. The life insurance industry came under stress because, instead of the traditional role of insurers in diversifying risk through the pooling of many lives, many vehicles, and many properties, the insurers assumed the rule of guaranteeing market returns. Insurance regulators never identified or examined the potential for systemic risk to the financial system associated with insurance companies taking on ever-greater promises of consumer returns on market investments.

The history of insurers and the State regulation leading up to and following the financial crisis is essential for evaluating the Dodd-Frank Act. And, in my opinion, the Dodd-Frank Act has benefited insurance consumers and improved the capabilities of State insurance regulation.

In terms of the Federal Reserve regulation, the Dodd-Frank Act created the Financial Stability Oversight Council (FSOC) and also

created the Federal Insurance Office (FIO). By doing so, the Federal Reserve or the Federal Insurance Office and the FSOC can identify systemically risky insurers, but they can also identify systemically risky products that may not on their own create a problem for one insurer, but if there are a bunch of insurers that are writing that product, then it becomes a systemic risk because of the product, not just because of an insurer.

So I see my time is up, and I am happy to answer any questions. Thank you.

[The prepared statement of Mr. Birnbaum can be found on page 32 of the appendix.]

Chairwoman BIGGERT. Thank you very much.

We have been called for a vote, those pesky votes that always come during hearings. So I think we will go and vote. And there are only two votes, so we should be back by 3 o'clock at the latest, and then we will continue on with the other two witnesses and get to the questions.

Thank you very much. We will be in recess.

[recess]

Chairwoman BIGGERT. We hope that some of our other Members will arrive back, but I think we will get started.

And I now recognize Mr. Chamness for 5 minutes.

STATEMENT OF CHARLES M. CHAMNESS, PRESIDENT AND CEO, NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES (NAMIC)

Mr. CHAMNESS. Okay. Thank you.

Good afternoon, Chairwoman Biggert, Ranking Member Gutierrez, and members of the subcommittee. Thank you for the opportunity to speak to you today.

My name is Chuck Chamness, and I am the president and chief executive officer of the National Association of Mutual Insurance Companies. NAMIC represents more than 1,400 property and casualty insurance companies, including small farm mutuals, State and regional insurance carriers, and large national writers. NAMIC members serve the insurance needs of millions of consumers and businesses in every town and city across America.

I would like to begin by thanking the subcommittee for its diligent oversight and review of the implementation of the Dodd-Frank Wall Street Reform Act. Preventing unneeded and damaging interference in well-functioning markets is key to our country's economic recovery. The committee's continued focus on this issue is critical.

To begin, it is important to recognize that property/casualty insurance is a fundamental pillar of the U.S. economy. Insurance is a mechanism that allows people to take the risks of owning property or starting a new business, and it allows businesses to expand with the knowledge that new risks can be managed. In short, insurance is a critical component of the Nation's economic vitality.

In terms of the industry's economic impact, the latest figures show there are upwards of 2,700 property/casualty insurance companies currently doing business in the United States, employing 600,000 people. In 2010, the industry paid $15.8 billion in State

taxes and invested $307 billion in municipal bonds to aid in the construction of various public-sector projects across the country.

In the wake of the 2008 financial crisis, NAMIC testified before Congress on the unique nature of the property/casualty insurance industry and urged lawmakers not to sweep the industry into any new conflicting and unneeded regulatory regime. Much to Congress' credit, the focus of the Dodd-Frank Act was not on the insurance industry, and the bill maintained the State-based regulatory system that performed remarkably well during the crisis. Despite the strain on the financial system globally, insurers remained strong and able to protect policyholders.

However, the sheer scope of Dodd-Frank has led to many changes in how insurance companies, particularly those that are large and diverse, deal with regulation. Despite not being the target of much of the new financial services regulatory regime, Dodd-Frank has led to an enormous amount of uncertainty for all insurers. Many of these consequences of reform appear to be unintentional—another reason that we are grateful to the subcommittee for holding this hearing.

I would like to highlight a few of our main concerns.

First, our industry has concerns over the size and scope of the new Office of Financial Research and its seemingly unchecked ability to impose expensive new data reporting and recordkeeping burdens on insurance companies and their customers. Although property/casualty insurance was carved out of its jurisdiction, the Consumer Financial Protection Bureau could attempt to bring the property/casualty insurance industry under its purview through indirect regulation of products and services, undermining congressional intent. Lastly, even the carefully constructed Federal Insurance Office, with its subpoena and preemption authorities, injects the insurance marketplace with new uncertainties about the future.

Second, another serious concern is the Volcker Rule, created to prevent proprietary trading in certain investments by banking entities. While Congress recognized the need to exempt insurers from the rule, it is not yet clear that the implementing agencies will also exempt insurers from the ban on investments in certain types of covered funds, as Congress intended. Allowing insurers to continue in their normal ownership of interest in securities is essential to appropriately engage in effective long-term investment strategies and avoid costly premium increases for policyholders.

Finally, I would address the role of the Federal Reserve. Before the passage of Dodd-Frank, insurance companies that owned depository institutions were regulated at the holding company level by the Office of Thrift Supervision (OTS). Dodd-Frank eliminated the OTS, and the Federal Reserve was given this responsibility. While the Federal Reserve has great experience in supervising and regulating traditional banking operations, it does not have a history of insurance company regulation. The Federal Reserve must recognize the distinct regulatory approaches required to properly supervise insurance companies, which entail different measures for capital, financial strength, and stability than banks. In terms of regulation, one-size-does-not-fit-all and consequently, the supervision should be tailored to this economic reality. Unfortunately, the Federal Re-

serve has adopted a bank-centric approach, which creates challenges for insurance companies.

Industry concerns are many and varied but generally fall into four categories: one, the rulemaking process, which frequently provides insufficient time to process and respond to comment periods for new rules and regulations; two, the lack of expertise in the business of insurance and the Fed seeking to impose bank-centric models and metrics rather than relying on the functional State regulators; three, the inability or unwillingness to distinguish between insurance entities and banks when it comes to systemic risk and assessments for resolving failing financial institutions; and, four, the Fed's desire that all financial statements use Generally Accepted Accounting Principles, whereas insurers are required by their functional regulators to use Statutory Accounting Principles (SAP).

As we move forward, NAMIC stands ready to work with Congress to rectify any unintended consequences that inevitably emerge from any legislation of the size and scope of Dodd-Frank. Again, thank you for the opportunity to speak here today, and I look forward to answering any questions you may have.

[The prepared statement of Mr. Chamness can be found on page 43 of the appendix.]

Chairwoman BIGGERT. Thank you very much.

Mr. Quaadman, you are recognized for 5 minutes.

STATEMENT OF THOMAS QUAADMAN, VICE PRESIDENT, CENTER FOR CAPITAL MARKETS COMPETITIVENESS, U.S. CHAMBER OF COMMERCE

Mr. QUAADMAN. Thank you, Chairwoman Biggert, Ranking Member Gutierrez, and members of the subcommittee.

The insurance industry is the largest investor in the United States and the world. Insurers have to carefully match their assets with long-term liability, contingent liabilities, and also to meet the liquidity needs of their policyholders for the short term and long term. Accordingly, insurers are investors in debt and equity markets, government securities, commercial real estate, and residential real estate. These investments are executed with strict regulatory oversight, with high capital and liquidity ratios. Leverage ratios for insurance companies tend to be 3 to 1, versus 9 to 1 for financial institutions. The insurance industry is not prone to runs.

Through these activities, insurers are not only long-term prudent; they are also a stabilizing force within the capital markets themselves. The investment activities of insurance companies allow them to meet the needs of their policyholders while providing an invaluable flow of capital for Main Street businesses, allowing them to create jobs and grow.

Accordingly, the insurance industry as an investor is harmed by inefficient capital markets and ineffective oversight of those markets. Post-Sarbanes-Oxley, American capital markets were becoming less efficient through international competition and an ineffective financial regulatory structure.

Our patchwork financial regulatory structure was created in the New Deal, certain aspects of it as far back as the Civil War. At best, that antiquated system was trying to regulate a 1975-style financial market in the 21st Century. This led to uneven enforce-

ment, a lack of understanding of products and markets, and an inability to spot bad actors which drives them out of the marketplace.

Rather than dealing with these problems, Dodd-Frank instead supersizes them. Dodd-Frank preserves the status quo, does not streamline regulators, does not allow them to hire the market-based expertise that they need, and does not allow them to regulate the financial markets in 2025 rather than in 1975. MF Global and Peregrine are just some of the latest examples showing that the underlying problems have not been dealt with.

These difficulties continue to impose pressure upon the insurance industry and nonfinancial companies' ability to raise capital. Just let me raise two examples in Dodd-Frank itself.

With the Volcker Rule, the asset liability management practices of insurance companies are, by their definition, proprietary trading. Congress wisely decided to give an exemption to insurance companies for that. But what Dodd-Frank gives with one hand, it takes away with the other. Insurance companies, as with many nonfinancial companies, own banks. They do this to lower transaction costs or to provide additional services to their customers. By owning a bank, the insurance companies are brought back into the ambit of the Volcker Rule, and that also includes all of the compliance issues that go along with that.

Additionally, as an investor, the insurance company will have to go into the debt and equity markets that are now going to be subject to a potentially subjective trade-by-trade analysis and thumbs-up or thumbs-down approval or disapproval by five different regulators. This will force insurance companies to rethink their investment strategies and to possibly forego opportunities that were profitable for both the company and their policyholders themselves.

Finally, let me also talk about SIFI designations, which, even though it impacts only a few companies, will have broader impacts upon the insurance industry itself.

First off, as you have heard from many other people today, this will place a unique business model within a bank-centric style of regulation. This is no more than putting a square peg into a round hole.

Additionally, we not only have domestic SIFIs designations and regulations, we also have this on an international level as well. It is unclear as to how any disputes between the domestic and international regulators are going to be resolved. Similarly, if you take a look the insurance industry, where you could have a tripartite system of regulation, it is unclear how that is all going to work.

Additionally, as you have also heard a little bit today, there is a significant shift in risk of loss for nonfinancial companies that come within the ambit of systemic risk regulation.

So I know my time is about up, and I am happy to answer any questions that you may have.

[The prepared statement of Mr. Quaadman can be found on page 80 of the appendix.]

Chairwoman BIGGERT. Thank you so much.

We will now turn to Members' questions for the witnesses, and Members will be recognized for 5 minutes each to ask questions. And I will yield myself 5 minutes for the first questions.

Dr. Hartwig, in your published article entitled, "Bruised, Not Crushed," you note a key difference between insurance companies and banks, and that is risk appraisal. Can you explain to this committee how risk appraisal is a distinguishing factor between insurance companies and the banks, and how Federal regulators should approach regulating the two different industries based on the fundamentals of risk appraisal?

Mr. HARTWIG. Yes, risk appraisal, risk assessment, risk analysis, insurers are expert at assessing risk. And that is how they remain in business; they take in premiums that are commensurate with the risk. This is a different operating model than the banks have. Associated with each particular element of risk that is accepted is a particular duration of a liability associated with that. On the banking side, for instance in depository institutions, you have the ability for those who hold the liability, the depositor, to make an immediate demand on that.

That is just one of many, many differences associated with banks and insurance companies. The fact of the matter is that there are many reasons why, as I said in my testimony, over 400 banks failed during the financial crisis—and, actually, quite frankly, we are still counting—and no mainstream or traditional property/casualty insurer failed as a result of the financial crisis. And it has a lot to do with risk management.

And the risk management, the insurers, we heard some testimony earlier about leverage. Insurers were far less leveraged than banks. But there is a long tradition in this business. And we heard Mr. Chamness, who runs the National Association of Mutual Insurance Companies—I will tell you that the median age of a mutual insurance company is 120 years old. Okay? And that tells you a lot about risk management and insurers as it differentiates itself from the rest of the financial services industry.

Chairwoman BIGGERT. Thank you.

Then, Mr. Chamness, on page 8 of your testimony, you mentioned, "Failure to include an exemption for insurance operations, allow investment in covered funds and continue the use of qualified subsidiaries will subject these companies to costly and duplicative regulation and reporting requirements and thwart the sound investment practices designed to ensure solvency and stability in insurance markets."

Who should care about costly and duplicate regulations and reporting requirements? Should insurance consumers be concerned, or business owners?

Mr. CHAMNESS. In a word, yes.

As Dr. Hartwig referred to NAMIC, we are mutual insurance companies. In the case of a mutual, the policyholders' interests are aligned with the companies. As Representative Gutierrez talked about, our largest member, his insurance company, is effectively owned by its policyholders, and it operates for their benefit. So to the extent that the insurance company has higher operating costs, has to pay more to be in business to serve these policyholders, in the case of the mutual insurance company, the policyholder eventually pays.

I think the genesis of your question was around the Volcker Rule's impact on very large insurance companies that are savings-

and-loan holding companies now regulated by the Fed. And we think this is an opportunity for Congress to clarify that, as Mr. Quaadman mentioned, the Volcker Rule was intended to carve out the insurance industry. We think appropriately it would. We think that insurance regulation certainly covers this type of covered funds trading that is done for the general account of insurance companies and is appropriate.

But, unfortunately, it looks like in at least initial rules from the Fed, that will not be the case unless further work is done. So we would ask for, in your oversight capacity, if you could work with the Fed to encourage them to amend the proposed rule and include general account and separate account exemptions for covered fund ownership by insurance companies. We think that would go a long way toward preventing too much regulation that does create expense.

Chairwoman BIGGERT. Do you think that there have to be some statutory ways to fix this or can it be done just by not having the regulations or getting them to change?

Mr. CHAMNESS. I think the regulatory process would be the first, and the easiest, step right now in terms of the Fed's actions. Longer term perhaps legislation could also help clarify it, although we think that the language in Dodd-Frank was fairly clear about exempting insurance companies from the Volcker Rule.

Chairwoman BIGGERT. Thank you. My time is almost over, so I will yield back. I recognize the ranking member, Mr. Gutierrez, for 5 minutes.

Mr. GUTIERREZ. Thank you very much, Madam Chairwoman. First of all, I think we should distinguish—most people are going to think that it is their car insurance company or their home insurance company that we are really talking about here today in terms of who it is we need to be really vigilant about. I don't particularly have a problem. My credit card company, I think I have to watch them like a hawk, because they change the rules every day. All Americans should watch them, that is why Congress has passed. My bank, they love new fees and new connivances. All the time I have to watch them. I don't particularly have to watch my insurance company. If you get in a car accident, you call them up, and they fix it. They debit it from your account, they are reliable. I don't have a real problem with them.

But what we haven't discussed is, what about AIG? Now everybody says oh, well, that is not us, but it is. It is an insurance company, it is a large insurance company that made a lot of bad bets, a large insurance company that we had to put tens of billions of dollars into in order to make the markets solvent and calm. And it just seems to me that it isn't only the premiums that we pay to our insurance company that covers our car and our home and our life. Actually the insurance companies invest that money and when you have markets and they invest it in the markets, in capital markets as a matter of fact. I know we have said a lot about them. You heard a lot of testimony about how insurance companies invest in bonds, and keep our economy going. If you go and you evaluate why it is that municipalities are going into bankruptcy, they will tell you it is primarily because of the economy, but underwriting that economy are the home values and the inability to collect taxes

on those homes and the high foreclosure rate. So if you buy bonds, you want to make sure that our economy is strong, because you are a big bond holder, according to the testimony of the three representatives of the insurance companies, that is what it is that you buy. So we want to make sure that is there and that our economy is strong. We want you guys to have—but we also want to make sure that as you—the other thing is it just seems to me that insurance companies sell other products. They sell annuities which are directly tied to the capital markets which can fluctuate in value and if people make demands. I have another wonderful life insurance company, but if I were to get into trouble I would have to call it in and I am sure other people, and even though they have been in business for 150 years and they are a mutual, who knows why it was people would make demands on that and make a rush on that.

I want to make sure that we have within the scope of our conversation and dialogue today to understand that insurance companies are in the market, they are affected directly by actions of the market. And I can certainly see where it is that we might want to make some distinctions between insurance companies and other financial institutions. Certainly, that should be something that we should take a look at. But let's make sure that we understand there is a correlation and there are—and we still have the AIGs of the world that we need to deal with, and we need to make sure that we have supervision so that it doesn't happen again. Illinois can't watch AIG, Connecticut can't watch it. They can't watch it. We need someone who is going to watch it.

I would like to just ask Mr. Birnbaum one question, and that is the expense, could you talk about what is the expense? There has a been a lot of talk here today that this is burdensome and it is costing jobs and that it is very expensive, the regulatory apparatus we have. Could you speak to that?

Mr. BIRNBAUM. To some extent, yes, thank you. The cost of regulation is a very small portion of the amount of premium that consumers pay for all sorts of insurance. And I think the other thing that is really important to keep in mind is that insurance is really a pooling of consumers' money. What insurance companies do is they take consumers' money and they put that into a risk pool to diversify the risk of all those consumers. So when my colleagues on the panel say that insurers invest in capital markets, they invest in real estate, they buy municipal bonds, it is really policyholders who are buying those assets. The insurance companies are the intermediaries that are doing that.

The other thing that insurance companies do with policyholder-supplied funds is they spend it on lobbying and regulatory activities. So in my view, the cost of actual regulation at the State insurance level and now at whatever is left at the Federal level is a relatively small portion of the premiums that consumers pay. It is like pennies on the dollar.

Mr. GUTIERREZ. I guess their argument is, and it is one that I think we should take a look at, if you could just answer, should they be treated differently than other—than investment banking firms and banks?

Mr. BIRNBAUM. To the extent that insurance companies are doing different things than investment banks and commercial banks, than other types of financial institutions, they should be treated differently. But to the extent that they are doing the same things as banks or other types of financial institutions, then it seems reasonable that there would be a consistent set of rules for different players doing the same thing.

Mr. GUTIERREZ. Thank you.

Chairwoman BIGGERT. It looks like some of the other witnesses would like to respond to that, so I will yield you another minute.

Mr. CHAMNESS. If I could just add one thing, as far as I am aware, the one insurance company that at one point in time seemed to behave a bit like an investment bank was AIG, and I am not aware of any other insurance company at this point, at least within our membership, the mutual insurance industry on the property casualty insurance side, that exhibits any characteristic other than that of home, auto, commercial line insurance that is required for our economy and for the existence of homeownership and driving our cars and operating our businesses.

Mr. GUTIERREZ. I can't—is that correct? It sounds good to me.

Mr. BIRNBAUM. As I pointed out in my testimony, the life insurance industry certainly had problems following the financial crisis. They not only applied for TARP funds but they also went to insurance regulators seeking capital relief in the form of changed accounting rules and lower reserve requirements. And the property casualty insurers certainly made use of those changed accounting rules to beef up their capital on paper without actually creating new assets to protect consumers.

Mr. QUAADMAN. If I could just add as well, with AIG you had a situation where, number one, the traditional insurance portions of business were fine, they were solid. But AIG got involved in selling insurance and financial products that quite frankly, the regulators didn't understand. The regulators couldn't perform the appropriate oversight, which is what endangered the company. But with insurance, if there is a problem with the company, the policyholders remain whole, and that was true with AIG as well.

Chairwoman BIGGERT. I guess we could go on, this is a very good question, but we will move on to Mr. Hurt, the vice chairman of the subcommittee.

Mr. HURT. Thank you, Madam Chairwoman, and thank you for holding this hearing. I thank the witnesses for appearing and I apologize for not being here for your testimony, but I do thank you for your input on this important hearing. I want to follow up on something that Mr. Chamness and the Chair were talking about, and that is the application of the Volcker Rule and what the effect for insurance companies and shareholders as consumers, what the effect will be in the event that a final Volcker Rule restricts insurance companies' ability to invest. I was hoping, Mr. Birnbaum, that you could address that issue, and then I would like to hear from Mr. Chamness. I would like to hear him expand on what he was talking about earlier in terms of what are the potential effects, unintended and intended, in the event that takes place?

Mr. BIRNBAUM. Sure. Thank you, Congressman. If we look to what happened with AIG, even within the insurance companies,

there was some risky investing on the part of AIG. In my testimony I discussed AIG's use of security lending, in which they actually loaned out securities that were owned by the insurance companies. And with the cash that they got for loaning those out, they invested in risky assets like residential mortgage-backed securities. So when the borrowers of those securities came back and said, we want our cash back, AIG didn't have the money, because the residential mortgage-backed securities which were so risky had devalued so much. And at its peak, we are talking about $76 billion in securities lending.

So within the insurance company there was that type of thing that went on and regulators didn't know about it at the time.

Now, having said that, if AIG was involved in these other activities like credit default swaps, why would we exempt the entire group just because AIG had insurance companies? Why would we exempt the entire operation from any oversight over these trading of risky derivatives? It seems to me that Congress got it exactly right when you said that when you are engaged in the business of insurance, the Volcker Rule doesn't apply. When you go outside of that, then there is going to be some oversight on the use of derivatives and that kind of trading.

Mr. HURT. Okay. I would like to hear from Mr. Chamness and anybody else who would like to comment in my allotted time, but when you are talking about prohibiting a certain source of investments, there are going to be consequences, and I would like to have a better understanding from you all what those negative and positive consequences will be.

Mr. CHAMNESS. Thank you for the question. I think I agree with where Mr. Birnbaum ended up, which is that there are two separate rules, Congress got it right. Volcker basically exempts insurers from the preemption that was designed for banks.

The fact is that insurance companies depend on their investment income that helps pay—it helps add surplus and increases their capacity to do business and serve policyholders. So to have some kind of unintentional restriction on their ability to invest with their own accounts was not what Congress intended, and we would like to make sure that in the Fed's regulatory process, that is clarified.

Further, in terms of large insurance holding companies or savings and loan holding companies that have insurance affiliates, one concern is that because they have separate investment affiliates, again unintentionally or Congress' intention was to not prohibit these insurance companies from being able to invest in their separate investment affiliates, we are concerned with the way the Fed's regulation has been drafted that could in fact be the outcome, that there would be some prohibitions on the savings and loan holding companies that are affiliated with insurance companies. And we think that through your oversight if you could help urge the Fed to let go of that, it would be helpful.

Mr. HURT. Thank you. Mr. Quaadman?

Mr. QUAADMAN. Yes, Mr. Hurt, thank you. Just to add two things, Federal Reserve Governor Tarullo testified before the committee at this very table on January 18th on the Volcker Rule and banning proprietary trading, that the proprietary trading was not a cause of the financial crisis. So the rule itself and its application

on the insurance industry does not deal with the financial crisis itself.

The other issue is that the regulatory complexity of the Volcker Rule, and I know Ranking Member Gutierrez raised JPMorgan Chase before. I only raise that in the context that you have the trade which has been well-publicized now, you have 100 examiners embedded within JPMorgan Chase, here we are 3 months after that trade was first reported in the press, and those examiners still cannot say whether or not those trades were proprietary. The Federal Reserve and the OCC and the SEC and the CFTC and the FDIC, how are they going to be able to say, millions of trade a day in the marketplace are either proprietary or not. It is just an unworkable system.

Mr. HURT. Thank you. And my time has expired. I thank the Chair, and I yield back.

Chairwoman BIGGERT. The gentleman's time has expired. Mr. Miller of California is recognized for 5 minutes.

Mr. MILLER OF CALIFORNIA. Thank you, Madam Chairwoman. Just so there is no confusion, no one is arguing that there shouldn't be strong capital standards. We argue that there should be appropriate capital standards, and that is where the confusion lies.

Mr. Chamness and Dr. Hartwig, we have heard concerns that the Federal Reserve's new capital requirements for savings and loan holding companies that are owned by insurance companies, can you explain why insurance companies and banks currently have different capital standards? And if the Fed chooses a more bank-centric standard as currently imposed, how would that impact the insurance industry?

Mr. HARTWIG. Maybe I will start, and then I will hand it off to Mr. Chamness. I don't think it comes as any surprise that banks and insurance companies have different capital standards today. There are also different accounting standards that exist between them. It gets back to the very heart of what we were talking about originally. These are very, very different enterprises. Insurers historically have always been operated on a very, very conservative basis. They have been regulated historically of course by the States. The States have developed over time a form of regulation that has worked quite well, if we look at the history of 120 years of insurance regulation.

Over the past century or more when we look at banks which have had quite frankly a history of volatility, a situation where every 15 to 20 years there seems to be some extreme problem in the banking sector. The most recent financial crisis is only the most recent example of that. So over time we have developed two completely different systems, that address two different industries. And again, as I mentioned, when we think about the insurance industry we have to think about an industry where we have a particular type of liability which is fundamentally different from the sorts of liabilities that we see in a banking operation. And that leads to a much more conservative form of operation in the insurance industry than we have seen historically.

So maybe with that, I might want to turn it over to Mr. Chamness.

Mr. CHAMNESS. Yes, thank you for the question. And it is a good issue. Congress authorized the Fed to set capital standards for savings and loan holding companies and we think it is a difficult task. But I think the best first step for the Fed would be to basically adopt the regulation standards or capital standards that are in place right now in the State insurance regulation system. We are concerned that there will be a one-size-fits-all approach. As we talk about the difference between the banking industry and the insurance industry and their balance sheets, their purposes, their behavior over the decades, there are significant differences, and so we don't think a one-size-fits-all capital approach is appropriate. We know that in the hundreds of pages in the Fed's June 7th risk-based capital proposal, which is intended to implement Basel III, there is frankly an inappropriate look at insurance capital requirements, it would redefine capital, eliminating some of the forms of capital used by the insurance industry, particularly mutual insurance companies, for more than 100 years, structures like surplus notes which are subordinate to regulatory approval, but a form of debt that is counted as surplus. We think that is a problem with current regulation on the savings and loan holding company capital.

We were encouraged that last week Chairman Bernanke testified that the Fed is at work recognizing the differences between insurance and bank holding companies and that they would recognize them and implement based on the differences between the two companies. And we think capital standards is surely an area where there deserves to be some difference.

Mr. MILLER OF CALIFORNIA. If he follows up with a statement, you would probably would be fine.

Mr. CHAMNESS. Excuse me?

Mr. MILLER OF CALIFORNIA. If he follows up with a statement, you would probably would be fine.

Mr. CHAMNESS. Exactly. I will tell you if they continue on the one-size-fits-all approach, which we disagree with, they at least should have a longer implementation period. Right now, Basel III is on track for, I think, January of next year. There is no way insurance companies, these large, newly regulated by the Fed insurance companies, can be in compliance by then.

Mr. MILLER OF CALIFORNIA. And that wasn't the direction of Congress either. It was very clear.

Mr. CHAMNESS. It wasn't. They would need at least 3 years, but we would rather they didn't have to comply.

Mr. MILLER OF CALIFORNIA. Mr. Chamness, I have a question. I was reading your testimony. You say, "Potential adverse impacts of the Dodd-Frank Act upon the insurance industry's ability to act as an investor will have serious consequences for Main Street businesses." My question has two parts. First, can you explain to the committee how regulations stemming from Dodd-Frank could inhibit the insurance and its ability to make critical investments in the U.S. economy? And second, is there a domino effect for the business and jobs and other sectors of the U.S. economy if they take their course?

Mr. QUAADMAN. Sure, and thank you for the question. I think the Volcker Rule is probably the most stark example where we had the

subjective regulatory approval or disapproval of trades. And if insurance gets wrapped up in proprietary trading, either they have to rethink their investment strategies or they actually have to start to leave some of the markets because the insurance industry as a capital provider with equities but also with debt because the debt markets far outweigh the equity markets, is a big provider of capital. So if they feel there are regulatory impediments in going into those markets, that becomes problematic. Also, I think it is important to realize that this isn't happening in a vacuum, particularly in the insurance industry. You have Dodd-Frank, you mentioned Basel III, you have the rewriting of insurance accounting rules, you have solvency too that is being negotiated. Those are also impacts that are going to be felt by the insurance industry. But the capital impacts on the insurance industry are also subject to other capital providers as well. And as they retrench, and I think you have seen that a little bit, what will happen is if companies find that it is going to be more difficult to raise capital in the debt and equity markets, not only is there going to be less capital there, companies are going to have to have larger cash reserves. So if you look at the United States as traditionally about 14 percent of GDP or $2.2 trillion, if you start to ramp up to numbers that you see in the EU, which is about 21 percent, that is $3.3 trillion, which means that is $1.1 trillion that is taken out of a productive means for the economy.

Mr. MILLER OF CALIFORNIA. Thank you. I yield back.

Chairwoman BIGGERT. The gentleman yields back. The gentleman from California, Mr. Sherman, is recognized for 5 minutes.

Mr. SHERMAN. My focus is on insurance that isn't called insurance. Basically, when we use the insurance industry to shift risk, I pay a small fee, and if something bad happens to me, you the industry writes me a big check. We have insurance reserves for that and through this great economic crisis the regulated insurance companies have done quite well. And if I had an $80 billion portfolio of mortgage-backed securities and I come to you for insurance and say please ensure that this portfolio will never be worth less than $70 billion, I believe that would be an insurance contract and you have to have reserves. But instead we could evade the insurance laws by saying we will do something different. Give me the option to put to you my $80 billion portfolio in return for $70 billion of U.S. Treasuries. And that isn't an insurance contract. If it doesn't have any reserves, it could take the whole economy down, and it almost did.

What do we do so that "pay a small fee, get a big check if something bad happens" contracts are subject to either Federal or State insurance regulation and have adequate reserves?

Why don't I address that first to Mr. Birnbaum?

Mr. BIRNBAUM. Thank you, Congressman. I think that is exactly the approach in the Dodd-Frank Act, which basically says that insurance is regulated by the States as it has been and to the extent that insurance companies are engaged in insurance activities, their activities are in fact regulated by the States. When insurance companies start engaging in noninsurance activities, then Federal regulators get involved. And that only makes sense. It was not only—

Mr. SHERMAN. For these purposes, a credit default swap would be classified, I would say misclassified, as a noninsurance activity?

Mr. BIRNBAUM. That is right. State insurance regulators looked at credit default swaps and said they were not insurance.

Mr. SHERMAN. Looking of course at the legal technicalities rather than the economic substance.

Mr. BIRNBAUM. The bottom line on that was while State insurance regulators were regulating the insurance subsidiaries, the insurance companies of AIG, they weren't looking at what AIG was doing with credit default swaps. So whether you believe that insurance regulators did a great job with the insurance company subsidiaries, they weren't able to look at the broader picture.

Mr. SHERMAN. The ship didn't sink and there was a terrible storm. That is my definition of being a good ship builder. So I will give them credit for that.

Let me turn to the three insurance industry representatives here. As representatives of the insurance industry, can you at least name one aspect of the Wall Street Reform Act that you believe has improved the industry?

Mr. CHAMNESS. I appreciate the question, and I think the derivatives regulation was generally helpful and an improvement post-Dodd-Frank.

Mr. SHERMAN. Mr. Quaadman?

Mr. QUAADMAN. Thank you, Mr. Sherman. First of all, thank you for all of your hard work on lease accounting. We greatly appreciate what you did there. I would also say that the clearing of derivatives for financial speculation purposes was a good thing. We think there should be an exemption for corporate end users but we do think that derivatives clearing was good.

Mr. HARTWIG. I might just add in addition to the derivatives, the fact of the matter is that Dodd-Frank did explicitly recognize the unique nature of insurance, by and large. We are here today talking about some residual issues and some issues which I don't think were intended ultimately by the act by Congress, and we are here to discuss those today.

Mr. SHERMAN. Thank you very much. I yield back.

Chairwoman BIGGERT. The gentleman yields back. The gentleman from North Carolina, Mr. McHenry, is recognized for 5 minutes.

Mr. MCHENRY. Thank you, Madam Chairwoman. Thank you all for your testimony, and thank you for being here today. And Mr. Quaadman, in your written testimony, you say potential adverse impacts of the Dodd-Frank Act upon the insurance industry's ability to act as an investor will have serious consequences for Main Street businesses. Explain.

Mr. QUAADMAN. Sure. As I mention in my oral statement as well, the insurance industry is the largest investor in the world, both globally and within the United States. They are key players in the debt and equity markets and are the largest holders of both instruments. So in that context, the insurance industry is a main provider of capital for Main Street businesses, large and small. If there are regulatory impediments that start to seep through Dodd-Frank, and if the insurance industry has to retrench into investment strategies, that will make it more difficult for Main Street

businesses to tap capital. The other thing that is important to recognize, too, as the insurance industry is a large investor, they have to do so through regulatory oversight. So they are not investing in junk; they are investing in highly rated products in good companies.

Mr. MCHENRY. So what happens if they pull out from—you outlined about a trillion dollars of pull out potentially if we look like Europe in terms of regulatory structure for insurance. What does that mean? Tell me what that means for my constituents.

Mr. QUAADMAN. What that means is that the person who is going to be on Main Street or the businesses that are in your district, there is going to be less capital to go around, there is going to be less liquidity to go around.

Mr. MCHENRY. Which means higher rates for what is then available?

Mr. QUAADMAN. That is correct.

Mr. MCHENRY. So the availability of credit goes down.

Mr. QUAADMAN. Yes.

Mr. MCHENRY. Your access to it goes down even more.

Mr. QUAADMAN. That is correct.

Mr. MCHENRY. And that which is available is more costly.

Mr. QUAADMAN. That is correct. And you also have a different distribution of capital. So as other forms of capital have to take the place of, let's say, insurance, that entrepreneur who is in the garage trying to make the next big product isn't necessarily going to have any funds available for him to be successful.

Mr. MCHENRY. Mr. Birnbaum, do you see it the same way?

Mr. BIRNBAUM. No, Congressman. No, I don't really see it that way. I am having a hard time following the concept that any restrictions on sort of noninsurance investments by an insurance company that is part of a savings and loan holding company will somehow result in insurance companies removing a trillion dollars from their investment portfolio. It just doesn't make any sense. Insurance companies gather policyholder funds and put that into a risk pool to protect the policyholders. And in doing so, they invest that in a variety of things. So why would they at some point decide, we are going to go on strike, we are going to put that money in cash and not invest it? It just doesn't make sense to me.

Mr. MCHENRY. Mr. Quaadman, how does it make any sense?

Mr. QUAADMAN. As I said before, and this is on a macro level, if insurance and other investors are no longer available to be players in the capital markets, companies are going to have to increase cash reserves, and that is where we came up, that is why I mentioned before about the $1.1 trillion that is taken out, because companies are going to have to hoard the cash and they are going have to also change their borrowing strategies as well.

To give you one example with a mainline company, their costs when they go out and sell commercial paper is 47 basis points. When you start to add in the Volcker Rule itself, that probably adds in another 50 basis points, but more importantly, if the commercial paper market is shut down for that company's purposes because of the regulatory scrutiny of the Volcker Rule, which is not an unusual circumstance, or may not be an unusual circumstance, they then have to access bank lines of credits which are prime plus

1, or at this point 4.25 percent, almost 10 times the amount. So that is among the ways that capital costs will increase for mainline businesses.

Mr. MCHENRY. So in short, regulation inhibits access to credit and drives up the cost of credit.

I have no further questions. I think it is self-evident that the cost of Dodd-Frank is real to consumers, and if we don't get this thing right, we are going have an even worse impact on the economy than we have already seen.

With that, I yield back.

Chairwoman BIGGERT. Thank you, and I will yield myself another round.

Mr. Quaadman, you note in your written testimony that when reviewing the Dodd-Frank Act, policymakers must take into account the impact upon capital formation for nonfinancial industry and ameliorate negative impacts. You say that failing to do so will consign the economy to anemic growth and the United States will not be able to create the 20 million jobs over 10 years needed for a prosperous economy.

Can you help this committee understand the impact that the insurance industry has on the U.S. economy, specifically with respect to prosperous growth and job creation?

Mr. QUAADMAN. Sure. And thank you very much for that question. As we look at these issues, we look at it from the vantage point of if a corporate treasurer has to be to go into the capital markets, how does it impact them? And what has happened with Dodd-Frank and when Congress looked at Dodd-Frank, I think what had happened is that policymakers looked at the financial services industry itself and decided to go after the financial services industry but didn't realize that the industry itself was really just a conduit between investors and businesses. So that if you start to tinker around with the Volcker Rule, insurance may not be exempt from the Volcker Rule. When you start to look at different aspects of it like that, when you see the insurance industry as being the largest investor in the United States for businesses, those regulatory impacts have an impact upon the corporate treasurer's ability to raise capital, both for everyday liquidity needs but also for growth opportunities. So if businesses don't have access to capital and can't expand, they can't create jobs.

Chairwoman BIGGERT. Thank you, and just one more question, to you or whoever wants to answer this. You note in your testimony that a quandary for regulators in the insurance industry is the designation and regulation of Systemically Important Financial Institutions (SIFI).

How would the designation and regulation of SIFIs under the Dodd-Frank Act affect the insurance industry and the U.S. economy?

Mr. QUAADMAN. I thank you very much for that. I think it has effects in two ways. First, as has been said before, the regulations with systemic risk and the Orderly Liquidation Authority (OLA) are very bank-centric. So you have the Federal Reserve, you have the FDIC, they are really looking at it through the traditional lens as a bank regulator. The problem is when you start to take a look at nonbanks that could be designated. So let's take insurance as an

example. You have an industry where you have a long-term matchup of asset and liability, which is much different than banks, if you take a look at nonfinancial companies, you have Congress actually trying to keep as many of those companies out of it. But what has happened is that the Federal Reserve has been looking at the implementation of this through very bank-like ways. So they have not been willing to create regulations that deal with different business models and that is going to cause regulatory mismatches.

The second way that I think it negatively impacts it is that when you take a look at the bank-centric system, the FDIC system of insurance really spreads the cost and the risk as well as the opportunities around the entire industry when a bank goes under. When you take a look at nonfinancial companies and insurance companies, if they are going to go under the risk of loss is on management and the shareholders of that company. Now if you start to designate insurance companies and nonfinancial companies, they are going to be operating under a risk of loss where they are dealing with the assessment system within Title II that means that their risk of loss may be different than their competitors, and that could have negative impacts on the economy.

Chairwoman BIGGERT. Thank you. Dr. Hartwig, would you like to comment on that?

Mr. HARTWIG. Sure, just to follow up on that. It is somewhat odd, as we currently see under Dodd-Frank, that we would have large insurance companies that are not designated as Systemically Important Financial Institutions but pass some sort of threshold of say $50 billion or so that ultimately wind up having to clean up the pieces for what goes on down at Wall Street. And as I think as we just heard we are talking about a situation where insurers that are not involved in any of these businesses, that are not even designated as Systemically Important Financial Institutions have to in effect hold capital aside, particularly if economic times look dark, not because of their own particular operations, which could be run to the most exacting standards of the States in which they are regulated. They could have a top rating, an A-plus rating from the ratings agencies like A.M. Best but nevertheless still now have to set aside capital in the event that some company over which they exercise no control goes under. And that could have the impact of reducing the availability and increasing the cost of insurance to all consumers.

Chairwoman BIGGERT. Thank you. Mr. Chamness?

Mr. CHAMNESS. Just one thing. I certainly agree with what has been said so far, but I would add one point we haven't talked about yet, which is an unintended consequence, but if you are a property casualty insurance company and you are deemed systemically significant, the market may view you as too-big-to-fail; in other words, absolutely secure and most likely to pay claims. And we obviously would see that as a disruption in the insurance marketplace because it would not be Congress' intent or the regulators' intent to give a SIFI designation in the insurance industry the role of making that SIFI designated insurer some kind of "super-sound, too-big-to-fail, most-likely-to-pay claims" participant in the market.

Chairwoman BIGGERT. Thank you.

And with that, I would like to ask unanimous consent to insert the following materials into the record: a June 24, 2012, statement from the American Council of Life Insurers; and a June 24, 2012, statement from the Property Casualty Insurers Association of America.

Chairwoman BIGGERT. With that, I would like to thank all of the witnesses. 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 30 days for Members to submit written questions to these witnesses and to place their responses in the record.

With that, I would like to thank you all. You have been a wonderful panel and the expertise that you all have, even though you may not all agree exactly with each other, but we really appreciate the views that you have brought to us today. This has been a very important hearing. Thank you very much.

With that, this hearing is adjourned.

[Whereupon, at 4:08 p.m., the hearing was adjourned.]

A P P E N D I X

July 24, 2012

Statement by Rep. Bill Posey (FL-15)
Hearing on "The Impact of Dodd-Frank's Insurance Regulations on Consumers, Job Creators, and the Economy"
House Subcommittee on Insurance, Housing and Community Opportunity
July 24, 2012

Chairwoman Biggert, Ranking Member Gutierrez and colleagues:

Thank you for the opportunity to speak before the Insurance subcommittee today.

I devoted a great deal of time to insurance issues as a legislator in Florida – insurance of all kinds, not just the type Florida's weather tends to inspire discussions about.

Florida is a large state, with many different kinds of insurance-related challenges to deal with. Last year, premiums written by property/casualty insurance companies in Florida totaled over $37 billion; premiums by life and health insurance in Florida totaled over $42 billion. Premium taxes paid in Florida were over $667 million in 2010. Those are big numbers, but behind the numbers are real people and real families.

I don't know anyone who likes to pay insurance premiums, let alone higher premiums. No one likes to think about the day when they might need that policy to be there for their home, or car, or to help provide financial security after the passing of a loved one. But, when insurance functions as it is supposed to, we appreciate its value to help us manage life's many risks. It is important that we in Congress get this issue right because it affects virtually everyone we know and care about.

I have our discussion draft bill that would address a problem brought to our attention with the new financial regulation bill, Dodd-Frank. Madam Chairwoman, I would like to submit for the record the latest draft of this bill to address this problem.

Last November, this Subcommittee had a hearing on discussion draft legislation that would except insurance companies from the FDIC's new "Orderly Liquidation Authority" and "Orderly Liquidation Fund" for large Wall Street institutions, and those determined to be systematically important, or as some say, "Too Big To Fail."

Under Dodd-Frank, the FDIC, the traditional banking regulator and insurer of deposits, oversees the new fund for these mega-financial companies. Whatever views my colleagues may have regarding bailouts – and I oppose them – I hope we can correct an injustice in Dodd-Frank that impacts insurance companies and our constituents.

Right now, the FDIC has the power to assess fees to create this new fund. However, in addition to assessing big Wall Street firms, for which the fund is intended, the FDIC can force insurance companies to pay into it. This is the case even though they are not eligible to use and do not need the fund. The insurance sector could be footing the bill for failed Wall Street firms. Back home, this means our constituents, the ones who pay the premiums, will have to pay higher insurance rates to cover risks on Wall Street. Why should our constituents pay higher life or property/casualty insurance premiums for bad decisions on Wall Street?

This draft bill would exempt insurance companies from paying into the liquidation fund. It is similar to a draft circulated and discussed by this Subcommittee last November, but I believe it has been improved with the help of the Chairwoman and others interested in this issue.

The insurance industry did not cause the financial crisis. As we debated Dodd-Frank, we seemed to agree that regulation of insurance was generally best left to the states. For decades Congress has recognized that state authorities have the expertise, proximity, track record, and federalist Constitutional authority to regulate insurance. Insurance companies pay into state guaranty funds to deal with insolvencies.

Shaking down insurance companies for Wall Street failures has big economic consequences, considering the insurance sector provides millions of jobs and tens of billions of dollars in state and federal revenue (property-casualty and life $18 billion in 2010). Insurance companies invest in the capital markets: in U.S. government, municipal and other bonds and securities. We may take it for granted, but insurance helps pay for projects like roads and schools.

In closing, forcing insurance companies to pay twice, into the state guaranty funds and the new federal liquidation fund, could have widespread repercussions for our constituents and the economy. Thank you again for the opportunity to speak today. I hope we can work together on a common sense fix to address this issue.

Statement of Birny Birnbaum
Executive Director
Center for Economic Justice

Before the

Subcommittee on Insurance, Housing and Community Opportunity
Committee on Financial Services
U.S. House of Representatives

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

July 24, 2012

Chairman Biggert, Ranking Member Gutierrez and Members of the Subcommittee, thank you for the opportunity to speak on the impact of the Dodd Frank Act (DFA) on insurance consumers, insurers and the economy. My name is Birny Birnbaum and I am Executive Director of the Center for Economic Justice (CEJ). CEJ is a non-profit organization advocating on behalf of consumers on insurance, credit and utility issues. I have been intimately involved in insurance regulatory policy issues for over 20 years as a regulator and as a consumer representative. I have been an active participant at the National Association of Insurance Commissions (NAIC) and the National Conference of Insurance Legislators (NCOIL) for many years.

To evaluate the impact of the DFA on insurance consumers and insurer, it is necessary to review how the insurance industry contributed to, and was impacted by, the financial crisis starting in 2007. Representatives of the insurance industry have argued that the property casualty industry was not responsible for the economic crisis and poses negligible risk to the financial system.[1] Industry has also testified that state-based insurance regulation has been adaptable, effective and responsive to local and regional markets.[2]

My experience and observation is that insurers did contribute to the financial crisis and the limitations of state-based insurance regulation became apparent as the crisis unfolded. State-based insurance regulation certainly has its strengths, but the DFA has assisted and strengthened state-based insurance regulation.

[1] Andrew Furgatch on behalf of National Association of Mutual Insurance Companies before the Subcommittee on Insurance, Housing and Community Opportunity, July 28 201.
[2] Andrew Furgatch, July 28, 2011

AIG

On the property casualty side, we must start with the spectacular collapse of AIG, which resulted in a massive taxpayer bailout. AIG certainly contributed to the financial crisis because of its huge bets on credit default swaps. While state insurance regulators have argued that it was the non-insurance subsidiaries of AIG and not the insurance companies of AIG which caused the collapse of AIG, the fact remains that state insurance regulators were not able to monitor AIG at the broader holding company level. State insurance regulators had, and have, limited expertise with the non-insurance aspects of a holding company with significant insurance operations.

In addition, state insurance regulators missed risky investment activities by AIG insurers involving the lending of securities. An NAIC *Capital Markets Special Report*[3] describes how insurer investments contributed to the failure of AIG:

> As we analyze securities lending within the insurance industry, one incident that proved to be an invaluable lesson was with American International Group (AIG). Firm-wide risk management inefficiencies are believed to have played a significant role in AIG's overall financial stress. Although it is most known for the significant losses to AIG Financial Products' (AIGFP) credit default swap (CDS) portfolio, the onset of an overwhelming demand for returned cash by AIG's securities lending counterparties compounded the overall firm's liquidity constraints.
>
> Through its securities lending program, AIG generally loaned out securities owned by its insurance company subsidiaries. Between 2005 and 2007, rather than invest the cash collateral it received from the borrowers in conservative, short-term securities, AIG changed the direction of its investment strategy (without disclosing such change in its notes or to the U.S. state regulators) and mostly invested the cash in long-term subprime residential mortgage-backed securities (RMBS). AIG's securities lending portfolio had not been included on the company's balance sheet due to a liberal interpretation of the accounting requirements; therefore, there was no transparency with regard to how AIG had invested the borrowers' posted cash collateral. U.S. regulators became aware of this change in investment strategy during a financial examination in early 2007. Investing in the RMBS resulted in an asset/liability maturity mismatch, and, as it is common knowledge, these securities experienced significant market value declines as the financial crisis emerged. Due in part to the financial distress brought about by AIGFP's CDS portfolio losses, the borrowers in AIG's securities lending portfolio began to return the borrowed securities, requesting the return of their cash, to reduce their exposure to AIG as a firm. AIG was unable to meet the growing demands for cash by its securities borrowers; to do so meant that they would have to sell the subprime RMBS collateral that was now illiquid due to severe market devaluations. Liquidity constraints that developed due to losses on its CDS portfolio were made worse, therefore, by those developing within AIG's securities lending business.

[3] http://www.naic.org/capital_markets_archive/110708.htm

> At its peak, AIG's securities lending program had reached approximately $76 billion of borrowings outstanding. With the assistance of regulators, AIG was able to reduce this exposure to approximately $59 billion before the U.S. government bailout. In November 2008, the Federal Reserve Board and U.S. Treasury announced a restructuring of the U.S. government's financial support to AIG. Consequently, the Federal Reserve Bank of New York created Maiden Lane II LLC (ML II) in November 2008 to "alleviate capital and liquidity pressures on AIG associated with the securities lending portfolio of several regulated U.S. insurance subsidiaries of AIG". Funds provided by ML II were used to purchase RMBS from AIG's securities lending portfolio to help raise cash to return to the securities lending borrowers. As of year-end 2008, ML II had an estimated fair value of $20.5 billion (or $39.3 billion par value).
>
> While AIG's losses stemming from its securities lending program did not directly cause the changes in treatment of securities lending by the insurance industry, it did highlight a lack of transparency and varying interpretations of the accounting language related to these investments.

Financial Guaranty Insurance

There were other types of property casualty insurers which contributed to and were dramatically impacted by the financial crisis, including financial guaranty and mortgage insurance. Financial guaranty insurers – also known as bond insurers – mistakenly provided assurance for a variety of asset-backed securities, contributing to the sale of risky and destined-to-fail mortgage-backed securities. The table below shows the premiums and losses for financial guaranty insurers from 2001 through 2011.[4] After years of paying few claims in relation to premium, the bottom fell out starting in 2007. From 2001 through 2006, financial guaranty insurers earned about $13.6 billion in premium while paying out just 9.2% in claims. From 2007 to 2011, financial guaranty insurers incurred almost $37 billion in claims – more than 2.5 times the premium earned.

The financial guaranty insurance market has collapsed. In 2006, financial guaranty insurers wrote about $3.4 billion of premium. By 2011, the remaining financial guaranty insurers still permitted to write new business wrote only $1.1 billion in premium. Further, the weakness and failure of financial guaranty insurers ripple through the economy because the absence of financial guaranty insurance can create great difficulties for states and municipalities to issue debt. State insurance regulators have tried to help a large, weak financial guaranty insurer by splitting off the municipal bond insurance portion of the business from the asset-backed security part of the business.

[4] Data for 2001 to 2010 from NAIC *Market Share Reports for Property/Casualty Groups and Companies*, various years. Data for 2011 from Annual Statement State Page data compiled by CEJ.

Table 1: Financial Guaranty Insurance, 2001-11

Year	*Earned Premium ($ Millions)*	*Incurred Losses ($ Millions)*	*Loss Ratio*
2001	$1,422	$41	2.9%
2002	$1,867	$133	7.1%
2003	$2,389	$182	7.6%
2004	$2,474	$392	15.8%
2005	$2,686	$297	11.0%
2006	$2,725	$200	7.3%
2007	$3,023	$3,949	130.6%
2008	$4,011	$19,239	479.6%
2009	$2,663	$6,669	250.4%
2010	$2,332	$4,186	179.5%
2011	$2,084	$2,846	136.6%
2001-06	$13,564	$1,244	9.2%
2007-11	$14,113	$36,889	261.4%
2001-11	$27,677	$38,133	137.8%

Mortgage Guaranty Insurance

The private mortgage guaranty insurance market also contributed to and was crushed by the financial crisis. Today, the Federal Housing Authority is supporting the mortgage market by providing increased amounts of mortgage insurance. Table 2 shows the performance of private mortgage insurers from 2001 to 2011.[5] As with financial guaranty insurance, after years of very low loss ratios, mortgage insurers' poor risk management resulted in massive losses starting in 2007. The weak financial condition of mortgage insurers PMI caused the Arizona insurance regulator to order the company stop writing new business in October 2011. MGIC received a waiver of minimum capital requirements in order to continue writing new business in 2009 and a second waiver was granted two years later by the Wisconsin insurance regulator.[6]

[5] Data for 2001 to 2010 from NAIC *Market Share Reports for Property/Casualty Groups and Companies*, various years. Data for 2011 from Annual Statement State Page data compiled by CEJ.
[6] "State Regulators Approve New Waivers for MIs," *Insider Mortgage Finance,* January 25, 2012 at http://www.insidemortgagefinance.com/blogs/MIs-Obtain-New-Waivers-1000018864-1.html

Table 2: Primate Mortgage Insurance, 2001-2011

Year	*Earned Premium ($ Millions)*	*Incurred Losses ($ Millions)*	*Loss Ratio*
2001	$4,131	$1,064	25.8%
2002	$4,572	$1,321	28.9%
2003	$4,904	$1,876	38.3%
2004	$5,040	$2,008	39.8%
2005	$5,105	$1,833	35.9%
2006	$5,362	$2,210	41.2%
2007	$5,877	$5,503	93.6%
2008	$6,384	$13,586	212.8%
2009	$5,632	$12,014	213.3%
2010	$4,901	$7,838	159.9%
2011	$4,490	$8,737	194.6%
2001-06	$29,114	$10,311	35.4%
2007-11	$27,285	$47,677	174.7%
2001-11	$56,399	$57,988	102.8%

Title Insurance

Title insurers also contributed to the financial crisis by facilitating dangerous and risky home mortgages. The third largest title insurers, with 20% national market share failed. In all but one state, there is no guaranty fund for failed title insurers. If a title insurer fails, the title insurance policies – which are supposed to remain in force as long as the lender has the insured loan in place and as long as the borrower owns the property – cease to exist and borrowers would be required to purchase new title insurance policies for lenders. In the case of the LandAmerica failure, the failed insurer was taken over by another insurer thereby avoiding an insolvency that would have roiled mortgage markets and borrowers. The title insurance market now features four large national insurers writing over 85% of all title insurance.[7]

[7] Based on First Quarter 2012 countrywide market share.

Force-Placed Insurance

A discussion of the property casualty insurance and the financial crisis is not complete without mention of force-placed home insurance. As part of their mortgage agreements, borrowers agree to maintain insurance on the property serving as collateral for the mortgage loan. If the borrower fails to maintain the required insurance, the mortgage servicer force-places insurance on the property and charges the borrower for that force-placed policy. Table 3 shows the growth in high-cost force-placed home insurance (FPI). Despite significantly less coverage and fewer expenses than a regulator homeowners policy,[8] the average cost of a FPI policy is much greater than a homeowners policy. In Florida, the average LPI premium for one of the two large insurers writing nearly all the LPI business was over $6,500 from the period July 2008 through June 2009.[9] For consumers experiencing financial stress, the imposition of a hugely expensive FPI policy can make the task of staying or getting current on the loan insurmountable. Regulators in New York, Florida and California have begun to take action this year to address excessive rates, but for many years, insurance regulators took no action to address the high rates of FPI and the large sums paid directly or indirectly to mortgage servicers by the FPI insurers.

Table 3: Force-Place Home Insurance, 2004-2011[10]

Year	*Net Written Premium ($ Millions)*	*Loss Ratio*
2004	$796	33.1%
2005	$919	53.5%
2006	$1,074	29.0%
2007	$1,647	20.5%
2008	$2,209	23.3%
2009	$3,049	20.7%
2010	$3,223	17.3%
2011	$3,450	24.7%
2004-2011	$16,368	24.2%

[8] FPI does not include coverage for contents, liability or additional living expense following a catastrophic event.
[9] CEJ Testimony Regarding Praetorian Insurance Company Rate Filing for Force-Placed Insurance before the Florida Office of Insurance Regulation, Table 4, based on data presented by the insurer in its rate filing.
[10] Data source is Credit Insurance Experience Exhibit data from the creditor-placed home columns of part 4 plus the experience of QBE Insurance Corp and QBE Specialty reported in part 5 Other., compiled by CEJ.

Life Insurance and Annuities

The life insurance industry was greatly impacted by the financial crisis. Life insurers sought relief from the federal government in the form of TARP funds and from state insurance regulators in the form of lower claims reserve requirements and changed accounting standards to indicate greater capital with no change in the amount of funds available to protect consumers.

The problems experienced by the life insurance industry stem from the fact that life insurer products have been transformed over time from mortality protection to market return protection. Instead of selling products that simply pay claims in the event of death or long life, life insurers' products began to guarantee market returns. News articles from 2009 describe the situation:

> Many life-insurance companies, like others in the financial sector, got caught carrying too much risk when the financial crisis hit. Some were hurt by their variable-annuity businesses, under which they sold products often linked to equity markets that promised minimum payouts even if markets fell. Insurers also lost money on investments in bonds, real estate and other assets that back their policies.
>
> The life-insurance industry is a lynchpin of the financial system, providing millions of Americans with a safety net, and is an important source of savings and wealth management. An erosion of confidence in the industry could cause customers to redeem policies and create a cash crunch for some companies. Insurers also are big sources of capital throughout the economy, as they invest the premiums they receive from customers into bonds, real estate and other assets. Access to federal aid should help life insurers avoid further credit-rating downgrades and the need to raise capital under onerous terms.
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> On Thursday, an industry trade association hailed the news. "By extending funds to certain insurers, Treasury is taking the right step toward helping restore lending and liquidity to the marketplace," said Frank Keating, President and CEO of the American Council of Life Insurers. [11]
>
> The news will come as a relief to a number of iconic American companies that have suffered big losses made worse by generous promises to buyers of some investment products. Shares of life insurers have fallen more than 40% this year. Their troubles led to a string of rating-agency downgrades that, in a vicious cycle, made if more difficult for some insurers to raise funds.

[11] Wall Street Journal, "U.S. Slates $$ Billion for Insurers from TARP," May 15, 2009.

> The life-insurance industry is an important piece of the U.S. financial system. Millions of Americans have entrusted their families' financial safety to these companies, so keeping them on solid footing is crucial to maintaining confidence. If massive numbers of customers sought to redeem their policies, it could cause a cash crunch for some companies. And because insurers invest the premiums they receive from customers into bonds, real estate and other investments, they are major holders of securities. If they needed to sell off holdings to raise cash, it could cause markets to tumble.
>
> Life insurers had for a time seemed to be somewhat immune from the credit crisis, since they tend to invest in relatively safe assets in order to match their liabilities. These companies got into trouble for two main reasons, both tied to the weak financial markets. First, many of the roughly two dozen insurers that dominate the variable-annuity business made aggressive promises on these popular retirement-income products, guaranteeing minimum returns, no matter what happened to the stock market. With the market's decline, the issuers are on the hook for big payouts, though most of the payments won't come due for 10 or more years. Second, the insurers also have lost money on the investments in bonds and real estate that back their policies.[12]

The life insurance industry came under financial stress because instead of the traditional role of insurers in diversifying risk through pooling of many lives, many vehicles or many properties, the insurers assumed the role of guaranteeing market returns. Insurance regulators never identified or examined the potential for systemic risk to the financial system associated with insurance companies taking on ever greater promises of consumers' return on market investments.

NAIC Capital Relief for Insurers

In November, 2008, the life insurers went to state insurance regulators and the NAIC seeking "capital relief." The insurers asked for lower reserve requirements and changes to accounting rules. The changes to accounting rules were intended to increase the amount of assets recognized by state insurance regulators as acceptable for meeting capital requirements. The principal change was a greater recognition of deferred tax assets. With this change, insurers were able to state greater amounts of capital while, in reality, no additional funds were available to protect policyholders.

The NAIC appointed a working group, which worked quickly to recommend NAIC adoption of most of the insurer requests. But, in January 2009, under strenuous protests from consumer organizations, the NAIC voted not to adopt the capital relief measures and to examine the proposals more carefully. NAIC President Roger Sevigny stated "Simply put, the industry has not made a credible case for why we need to make changes on an emergency basis, and why those changes should be limited to the specific proposals made by the industry."[13]

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[12] Wall Street Journal, "U.S. to Offer Aid to Life Insurers," April 8, 2009

[13] NAIC News Release, "Regulators Deny Industry's Request to Lower Capital, Surplus Standards," January 29, 2009.

At that point, several states granted the capital relief by allowing their domestic insurers to deviate from the insurance accounting rules through state exceptions. These actions created a crisis for state insurance regulation as states which had not granted the capital relief to their domestic insurers had to choose between accepting and rejecting the other states' actions. The remaining states, through the NAIC, were eventually forced to adopt the capital relief proposals to maintain something close to consistent solvency regulation across the states.

The Dodd Frank Act Has Benefitted Insurance Consumers and State Insurance Regulation

This history of insurers and state insurance regulation leading up to and following the financial crisis is essential for evaluating the costs and benefits of the DFA on insurance consumers and insurance companies. The DFA has been very beneficial to insurance consumers and has improved the capabilities of state insurance regulation.

Federal Reserve Regulation

The DFA created the Financial Stability Oversight Council (FSOC) with the authority to designate a financial firm as systemically important and subject to supervision by the Federal Reserve. In addition, insurance companies that are part of a holding company with a bank or a savings and loan are subject to holding company supervision by the Federal Reserve. Given the history of failed oversight at the holding company level of AIG, these provisions of the DFA are reasonable and necessary. While the NAIC has attempted to improve its tools for supervision of holding companies with insurance subsidiaries, it is unclear what expertise insurance regulators have regarding the non-insurance activities of these holding companies. In addition to assigning the Federal Reserve the responsibility to bank and savings and loan holding companies with insurance operation, the DFA provided institutions to assist and inform the Federal Reserve in its efforts, including the Federal Insurance Office (FIO) and a member of FSOC with insurance expertise. As stated in the 2012 FSOC Annual Report, the Federal Reserve recognizes the risks and characteristics of insurers and the need to coordinate with state insurance regulators:

> In addition to its existing responsibility for supervision of a BHC that is a major life insurance company, on July 21, 2011, the Federal Reserve assumed responsibility for over 25 SLHCs that engage in significant volumes of life, property and casualty, or title insurance underwriting. The unique aspects of the insurance industry are addressed in various regulations that have been published for the BHC and SLHC populations. The Federal Reserve developed and implemented a specialized supervisory approach and customized supervisory guidance that reflects the risks and characteristics of the industry. This approach includes communications and coordination with state insurance regulators.

In addition, the DFA, by creating the FIO, provides the federal government with a subject matter expert on insurance to help FSOC identify systemically risky firms. The identification of systemic risk posed by insurance companies and cooperative supervision of holding companies remains vitally important. The need is illustrated by state insurance regulators recent actions with a relatively new product offered by life insurers – the contingent deferred annuity (CDA).

The CDA is a derivative sold to investors which guarantees lifetime benefits if the investor's portfolio is depleted before the investor dies. Unlike an annuity sold by the insurance company for which the investor transfers the assets to the insurance company, the CDA is a stand-alone guarantee. Instead of proceeding with caution on this new product given the problems insurers encountered with market-guaranty products in 2008 and 2009, the regulators are doubling down on the risky products. State regulators review of this product did not include an analysis of the potential for systemic risk posed by a product guaranteeing benefits after investments have been depleted from millions of retirees who would need the product in the same general time period in the event of a major market downturn. The existence of the FIO to provide broader analysis and the FSOC to address systemic risk is a huge benefit for insurance consumers from the DFA and fills a major gap in state insurance regulation.

Resolution Authority

The DFA gives the FDIC orderly resolution authority over a non-bank financial company under certain circumstance and if the failure would have serious adverse impacts on the financial stability of the country. This is another common-sense component of the DFA. To the extent that the state guaranty fund system is able to deal with the insolvencies of insurers, the FDIC's authority would not be required. But the state guaranty fund system is not comprehensive. As mentioned above, title insurers – whose product is necessary for mortgages to be sold – are not covered by guaranty funds. With two title insurers controlling two-thirds of the market and four title insurers controlling over 85% of the market, a failure by a top title insurer could pose systemic risk.

Volcker Rule

The DFA includes a provision – the Volcker Rule – that limits certain proprietary trading and speculative investments in derivatives. The DFA provides an explicit exemption from the Volcker Rule for investment activity of insurers. To the extent insurers engage in these investments for hedging purposes and are subject to state regulatory oversight, the Volcker rule would not apply. However, to the extent that insurers engage in proprietary trading for purposes other than the business of insurance, it is reasonable and necessary for this activity to be subject to the Volcker rule.

Federal Insurance Office

The creation of the FIO by the DFA is a great benefit to insurance consumers, the insurance industry and state insurance regulators. In addition to serving as the federal governemnt's insurance subject matter expert and assisting with the identification of systemically risky products and institutions, the FIO creates a true federal representative to participate in international insurance trade and regulatory issues in coordination with state insurance regulators. The interests of the insurance industry are better represented than before the FIO was created. Prior to the DFA, individual states and the NAIC entered in regulatory agreements with other countries and the NAIC was the voice of the United States in international regulatory issues. The DFA, through the FIO, strengthens the ability of state insurance regulators on international issues.

The DFA also authorized the FIO to examine issues of insurance availability and affordability in traditionally underserved areas. Insurance has long been recognized as essential for individual and community economic development and access to affordable insurance is necessary for individual to build and protect assets. Most state insurance regulators individually and the NAIC as an organization have, for decades, refused to examine and analyze availability issues. In particular, state insurance regulators have consistently refused to collect the detailed data necessary to even assess the state insurance availability and affordability in low-income and minority communities. The DFA gives the FIO authority to collect data from insurance companies, if and only if, those data are not otherwise available and not collected by state insurance regulators.

The Consumer Financial Protection Bureau

The most important part of the DFA for consumer protection was the creation of the CFPB. Although the CFPB has no jurisdiction over insurance products, the CFPB has and will continue to help insurance consumers as well as consumers of other financial products. The CFPB will work to ensure that financial products sold are transparent to consumers and, by doing so, will enable markets to operate more effectively to prevent the sale of dangerous and abusive financial products. The financial system is safer because of the CFPB.

In addition, the CFPB, with other federal regulators, will help fill the gaps created by insurance products sold in connection with loans – like payment protection and force-placed insurance. The CFPB recently took action to stop unfair and deceptive sales of payment protection products, which are the banking analog to consumer credit insurance regulated by state insurance regulators. The CFPB's action to stop unfair sales of payment protection stands in contrast to the limited activity of state insurance regulators regarding sales of consumer credit insurance. The CFPB and other federal regulators have taken steps to improve the performance of mortgage servicers, including servicer standards for force-placed insurance. In the void left by state insurance regulators, the CFPB has helped protect the insurance consumers

Conclusion

The DFA has produced solid benefits for insurance consumers, the insurance industry and state-based insurance regulation.

Statement

of

National Association of Mutual Insurance Companies

to the

United States House of Representatives

Committee on Financial Services

Subcommittee on Insurance, Housing and Community Opportunity

Hearing on

Dodd-Frank: The Cost to Insurance Consumers and Investments in Business and the Economy

July 24, 2012

The National Association of Mutual Insurance Companies (NAMIC) is pleased to offer comments to the House Financial Services Subcommittee on Insurance, Housing and Community Opportunity.

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

Property/casualty insurance is a fundamental pillar of the United States economy. Its continued functioning is critical to our ability to return the country to robust growth, and it is imperative that we carefully consider any action that might impair the insurance industry's ability to protect individuals and businesses.

To their credit, in crafting the Dodd-Frank Wall Street Reform and Consumer Protection Act ("DFA") [1], legislators recognized that the business of property/casualty insurance was not the cause of the recent financial crisis and that it is unique within the financial services sector. As a result, the industry was not the focus of the new financial regulations that were put in place and was specifically excluded from the purview of the Consumer Financial Protection Bureau. However, the scope of the DFA has led to many changes in how insurance companies – particularly those that are large and diverse – deal with regulation by the federal government. Despite not being the target of much of the new financial services regulatory regime, the DFA has led to an enormous amount of uncertainty for insurers.

We commend the committee for its diligent oversight and review of the DFA and urge Congress to continue its oversight of the federal institutions responsible for implementing the Act. As we move forward, we also urge Congress to move expeditiously to rectify the unintended consequences that are inevitable in any legislative initiative of this size and scope and to hold the agencies accountable for strict adherence to the letter and spirit of the legislation. For the insurance industry, the focus should remain on preventing unneeded and damaging interference in a well-functioning system.

We thank the committee for the opportunity to discuss the critical role property/casualty insurance plays in our markets and share some of our ongoing concerns in a number of specific areas.

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

The Importance of Insurance

Any assessment of the impact of the DFA on the property/casualty insurance industry must begin from an understanding of how the industry interacts with the broader economy as a whole. The constituents of our industry include policyholders (individuals and businesses), taxpayers, insurance companies, agents, and others affected by the insurance underwriting process. All would be impacted by market distortions caused by ill-conceived regulation.

Insurance is simply the transfer of a risk of a loss, from one person or entity to another, in order to protect oneself, one's property, or one's business from potential future events. Without the protection offered by NAMIC members and others, the incidence of business failure and personal financial ruin due to natural catastrophe or lawsuit would be dramatically higher, leading to far fewer start-ups and less economic growth. Insurance is the mechanism that has allowed people to take the risks of owning property or starting a business that is critical to the nation's economic vitality.

In addition to assisting in the management of risk,the property/casualty insurance industry plays a key role in the economy through its operations and investments. Latest figures show there are 2,689 property/casualty insurance companies currently doing business in the United States. According to the Insurance Information Institute, the property/casualty insurance industry employs upwards of 600,000 people not including agents and brokers.[2]

The importance of the industry in the economic wellbeing of states and local communities can be demonstrated in three major ways. First, insurers are required to pay premium taxes (usually 2 percent of their total direct written premiums) to state treasuries. In 2010, this amounted to $15.8 billion for the entire insurance industry, or $51 for every person in the country. This figure represents 2.2 percent of all state taxes.

Property/casualty insurance companies had $1.3 trillion in cash and invested assets on hand in 2010. Much of this amount is invested in highly liquid securities (stocks and bonds) that allow insurers to quickly turn the securities into cash if they are suddenly faced with paying claims as a result of a catastrophic event. Through a significant portion of these investments, insurance companies help fund the construction of schools, roads, and health care facilities, and a variety of other public sector projects through municipal loans and bonds. The property/casualty insurance industry invested $331billion in such bonds in 2010.[3]

A final way that insurers contribute to their local communities is through their charitable giving. In 2010, property/casualty insurance companies contributed a total of $500

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[2] http://www.iii.org/facts_statistics/careers-and-employment.html

[3] Board of Governors of the Federal Reserve System, June 7, 2012

million to charities, 80 percent of which came through direct cash contributions. The remainder represented employee cash donations and volunteer hours. About a third of the money went to support educational endeavors.

Over the last several years the property/casualty insurance industry has withstood the challenges of the financial crisis and weak economic recovery, as well as severe catastrophe losses. Last year ranked as the fifth most expensive year recorded for insured catastrophe losses, totaling $33.5 billion in the United States alone.[4] Profits dropped by about one half for the industry between 2010 and 2011 simply from the underwriting losses experienced.

Despite all that, the property/casualty insurance market remains highly competitive and well-capitalized with surpluses exceeding pre-financial crisis highs. Even amid severe financial turmoil, there were no major failures of property/casualty insurers and the industry as a whole greatly outperformed other financial services sectors. The sustainability and resiliency of our industry stems from the regulatory system in place, the unique nature of property/casualty insurance, the industry's low leverage ratios, its relatively liquid assets, the lack of concentrations in the marketplace and the conservative business models adopted by the industry.

As an example of such a business model, one of the common threads that bind NAMIC members together is our mutuality. The mutual philosophy is grounded in the belief that people and organizations can achieve great things when they work in concert toward common interests. The guiding purpose of a mutual company has always been to serve its policyholders. As mutuals, we exist solely for the benefit of our members – there are no shareholders. Premiums are paid into a common fund to cover policyholders' claims and the company takes a long view toward protecting their communities rather than their quarterly earnings report.

Uncertainty in the Insurance Market

The state-based system of insurance regulation was left largely intact by the DFA. Entirely new regimes were not created to focus on the property/casualty insurance industry. Yet that did not prevent the legislation from creating uncertainty regarding the future regulatory environment.

Office of Financial Research

The DFA created the Office of Financial Research ("OFR") within the Department of the Treasury and charged it with conducting financial analysis in support of the FSOC, looking at ways to standardize financial reporting requirements, developing a reference database, making financial data efficient and secure, and producing regular reports to Congress on threats to the financial system and its key research and findings.

[4] http://www.iii.org/articles/2011-year-end-results.html

The jurisdiction of the OFR is vague and there is potential for the office to grow beyond its scope as an information clearinghouse. In addition, the OFR has almost unlimited power to subpoena financial companies – including insurers – for information. The OFR raises concerns for insurers regarding duplicative calls for information, standardization and presentation of data, and confidentiality of information. Insurers have additional concerns regarding the type of information to be presented in the "publicly accessible database." Without context, this type of public information could be misleading and could pose concerns regarding confidentiality and proprietary information..

Insurers, like other financial institutions, will also be assessed new fees to fund the work of the OFR. There is legitimate concern that the assessment base used will not appreciate the difference in financial structure between banks and insurance entities and assessments will not apply fairly between all financial institutions.

Insurers have concerns over the size and scope of the OFR and the unchecked ability to expand and impose additional regulatory and expense burdens on insurance companies and their customers. NAMIC believes that sufficient, high quality information on the insurance industry is collected, analyzed and maintained by state regulators and that additional information collection, analysis and dissemination by the OFR is unnecessary.

Consumer Financial Protection Bureau

In the legislative language of the DFA, all lines of property/casualty insurance were expressly excluded from the jurisdiction of the Consumer Financial Protection Bureau. To date the bureau has worked within that jurisdiction. For example, NAMIC raised concerns with the construction of the complaint database and requested that insurance related complaints be excluded. We are pleased that the CFPB accepted our recommendations and constructed the online complaint database to direct anyone with an insurance complaint directly to the corresponding state regulator.

However, we remain concerned there are multiple avenues that the CFPB might pursue which would needlessly sweep the property/casualty industry under its regulations. NAMIC is concerned that the CFPB could seek to assert supervisory control over insurance company operations – which were explicitly excluded from its jurisdiction – by redefining insurance companies as other types of financial operators. Such an outcome is inconsistent with congressional intent and would disrupt the functional regulatory balance.

Federal Insurance Office

Although the Federal Insurance Office ("FIO") is meant to be a source of information and expertise and not a regulator, it was granted the authority to subpoena insurance companies for information as well as preempt state law for the purposes of complying

with international trade agreements. While it may be a rare occurrence when the FIO utilizes either of these powers, the fact remains that the office has them and it leads to further uncertainty about future regulation and compliance. NAMIC commends the committee for continuing to seek reassurances that FIO understands that its role is to monitor the insurance industry, not to regulate it, and to resist efforts to expand the authority of the office to supervisory functions. We also continue to urge FIO Director Michael McRaith to utilize his office to monitor the work of federal financial regulatory agencies and educate these agencies about the differences between insurance and banking, ensuring that federal regulatory proposals properly respect the authority of the states to regulate the business of insurance.

Volcker Rule

Section 619(a) of the DFA prohibits banking entities from engaging in proprietary trading and from investing in or sponsoring hedge funds and private equity funds. Congress recognized the importance of appropriately accommodating the business of insurance and provided an exemption from the Volcker Rule for an insurance company acting on behalf of its general account. Section 619(d)(1)(F) provides that, notwithstanding the prohibitions of Section 619(a), investing in "securities and other instruments described in subsection (h)(4) by a regulated insurance company directly engaged in the business of insurance for the general account of the company and by any affiliate of such regulated insurance company" is a permitted activity.

Further, Dodd-Frank mandated that the Financial Stability Oversight Council ("FSOC") study and make recommendations on implementing the Volcker Rule to "appropriately accommodate the business of insurance within an insurance company, subject to regulation in accordance with the relevant insurance company investment laws, while protecting the safety and soundness of any banking entity with which such insurance company is affiliated and of the United States financial system."

Despite this clear direction, the complexity of legislative language and the absence of a final rule have generated unnecessary uncertainty about whether investment limitations will in fact be imposed upon property/casualty insurers affiliated with an insured depository institution. Straying from the legislative intent to accommodate insurers would have the unintended consequence of severely restricting investment options, including ones that involve minimal risk. Allowing insurers to continue in their normal regulated investment activity from their general account, including engaging in proprietary trading and owning private equity and hedge funds, is essential to allow insurers to appropriately engage in effective investment strategies, including matching investment portfolios to anticipated liabilities.

A number of changes will be necessary in the proposed rules to ensure that the application does not jeopardize insurance company operations, including investments in

covered funds, the use of separate subsidiaries and participation in compliance programs.

With respect to covered funds, there is a concern as to whether the insurance company exemptions for proprietary trading apply to such investments. Covered funds include traditional hedge funds, private equity funds, and other funds such as certain foreign funds and commodity pools. The legislative history of Dodd-Frank shows that Congress clearly intended to exclude insurance company activities from the scope of the Volker Rule prohibitions on investments in covered funds.

Insurance companies invest in covered funds for the same reasons they invest in other types of assets – to ensure a sound investment strategy that will facilitate policy performance over the long-term, to effectively diversify portfolio holdings, and potentially earn higher returns. The ability to diversify an insurance company's investments is important to creating a balanced portfolio. Covered funds, provide a means by which companies can reduce correlation risk as they are less highly correlated with traditional stock and bond investments because of their short-term trading strategies. Investment in covered funds permits insurance companies to properly align both income streams and asset class durations with liabilities. The ability to engage in such investment is critical for insurance companies with long-tail policies in which the liability for coverage may not arise for a significant period of time. Lastly, covered funds provide insurance companies with access to high quality assets with potentially higher rates of return than other traditional assets.
Restricting the ability of insurance companies to utilize these investment asset classes would frustrate prudent long-term investment planning and introduce competitive disadvantages for insurance companies affiliated with depository institutions. It would be economically punitive for insurers if their investment trading were restricted so that they could no longer utilize their long-established basic business models. Therefore, in compliance with congressional intent and to protect the financial stability of insurance companies it is essential that the agencies amend the proposed rule to include General Account and Separate Account Exemptions for acquisition or retention of ownership interest in a covered fund by a covered banking entity that is an insurance company.

In addition to investing in covered funds, various state insurance laws allow an insurance company to invest in, or organize subsidiaries which may invest in, instruments on behalf of the parent insurance company. Under Section 13(d)(1)(F), affiliates of regulated insurance companies are permitted to purchase, sell, acquire, or dispose of assets for the general account of the regulated insurance company. Because such investment activities are specifically permitted, it would be inconsistent to deem the affiliate a covered fund sponsored by the insurance company, an activity prohibited under the Volcker Rule. Insurance companies should be allowed to organize or invest in wholly-owned subsidiaries or affiliates for the purpose of making investments, as permitted under applicable state insurance law, without that subsidiary being deemed a covered fund. Also, insurance company subsidiaries established under state insurance law should be specifically excluded from the definition of "covered fund." Such exemptions are consistent with the logic of the proprietary trading exemption and

the legislative intent of Dodd-Frank that the agencies accommodate the business of insurance.

Lastly, the proposed implementation of the Volcker Rule requires compliance with detailed reporting and recordkeeping requirements. These reporting and recordkeeping requirements are unnecessary in the context of insurance companies. State regulated insurance companies comply with strict investment laws that specify which types of assets domestic insurers may hold. Many of these state laws also prescribe limits on the amounts of each type of asset that an insurer may hold, as well as limits on the amount of investments in a single issuer that an insurer may hold. Additional state laws typically require the adoption of a written investment plan, including standards for the acquisition and retention of investments by the insurance company and oversight by its Board of Directors. State insurance laws also ensure that investments are valued correctly. The National Association of Insurance Commissioners' ("NAIC") accreditation standards, require that securities be valued according to the rules of the NAIC's Securities Valuation Office[5] and that other invested assets be valued according to the rules of the NAIC's Financial Condition (E) Committee.

In addition, state insurance regulators provide effective enforcement of the stringent financial and investment requirements. The NAIC's Model Law on Examinations, adopted in essence by nearly every state, requires each state's insurance department to conduct an on-site examination of each company domiciled in that state every three (in older versions of the law) or five years. Full- scope examinations are extremely thorough and include review of management and internal controls, corporate records, accounts, financial statements, and asset quality.

Dodd-Frank recognizes the validity of state insurance law and regulation unless the Federal banking agencies make a showing otherwise. Based on the breadth and quality of the state reporting and examination process and the statutory recognition of the state regulatory system, it is appropriate to exempt insurers from reporting and recordkeeping requirements of the Volcker Rule, including the compliance program requirements.

Failure to include an exemption for insurance operations, allow investment in covered funds and continue the use of qualified subsidiaries will subject these companies to costly and duplicative regulation and reporting requirements and thwart the sound investment practices designed to ensure solvency and stability in insurance markets. Our view is supported by the recent statement of the House Appropriations Committee that "the Committee believes that the traditional investment activities of state-regulated insurance companies for their general accounts, including investing in both sponsored and third-party funds, are preserved by the law without constraint." We urge the House Finance Service Committee, as well as the Appropriations Committee, to ensure that the revised regulations fulfill Congressional intent.

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[5] The SVO is a NAIC staff office that assigns asset quality designations (NAIC-1 for the highest quality, through NAIC-6 for obligations in default) and valuations.

The Federal Reserve

Before the passage of the DFA, insurance companies that owned thrifts and were organized as Savings and Loan Holding Companies ("SLHCs") were regulated at the holding company level by the Office of Thrift Supervision ("OTS"). The OTS was eliminated in the DFA and the Federal Reserve Board (the "Federal Reserve") was given responsibility for holding company regulation. While the Federal Reserve has experience and expertise in supervising and regulating traditional banking operations, it does not have a history of insurance company regulation. To successfully incorporate insurance-connected SLHCs into its supervisory regime, it is imperative that the Federal Reserve recognize the striking differences between the activities of many of the bank holding companies ("BHCs") traditionally regulated by the Federal Reserve and a number of insurance-connected SLHCs that will be supervised in the future.

These distinctions include significantly different financial reporting, accounting standards, capital requirements, and other operational activities. The information and standards that are critical to supervising a SLHC which is overwhelmingly engaged in insurance activities is fundamentally different than the information and standards critical to regulating traditional BHCs. The risk and exposure of insurance companies and the nature and utilization of their assets and liabilities can be significantly different from banks.

The Federal Reserve should fully recognize the distinct regulatory approaches required to properly supervise banks and insurance companies which entail different measures for capital, financial strength, and stability. In other words, it is not appropriate to mandate an accounting practice that is akin to fitting a square peg of information into a round regulatory hole. One size does not fit all, and consequently, the system of supervision should be tailored to this economic reality.

Unfortunately, notwithstanding a genuine effort to understand the business of insurance, the Federal Reserve continues to take a bank-centric approach to regulation making little allowance for insurance specific standards. For entities new to the Federal Reserve regulatory process that are still trying to interpret the meaning of bank-centric requirements, there is frequently insufficient time to process and respond to comment periods for new rules and regulations. Frequently, there are real and significant concerns that need to be addressed. The practical result of some regulations may not be immediately apparent and the Congress should urge the Fed to go slow and work closely with the insurance companies it now oversees. Furthermore, rather than working with state regulators and relying on the professional expertise of the functional regulators, the Federal Reserve is engaging in detailed investigations into insurance company operations. Such activities are duplicative, time-consuming, and costly for both the government and the insurance company, and could lead to conflicting determinations between regulators and inappropriate decisions.

Capital Standards

One of the greatest challenges some of our companies face today are proposed capital standards for SLHCs engaged predominantly in the business of insurance. The capital structures and regulatory treatment of bank and insurer capital are markedly different because their respective business models are different. In simplest terms, banks take deposits and lend those deposits to others in the form of loans. Since depositors always have the right to call in their deposits, banking capital regulation is focused on asset quality and liquidity to meet depositor demands. In contrast, an insurance consumer pays premiums for a contractual promise to pay for a covered loss—such as an automobile accident. The insurer does not lend out those premiums, but uses them to pay claims and invests them to match expected liabilities. Insurance regulation is focused on liabilities, ability to pay claims as they come due, and regulating capital in manner that matches assets to liabilities. Naturally, banking regulation has developed and evolved around entities engaged predominantly in the business of banking—with recognition in recent years that some banks may also have a relatively small insurance operation.

While Congress authorized the Federal Reserve to set capital rules for SLHCs, the requirement for capital rules and consistent standards doesn't change the fact that many SLHCs are very different than BHCs.

We understand that the Federal Reserve has an extraordinarily difficult task in developing multiple rules under DFA and in addressing areas and companies not previously under their jurisdiction. We appreciate the difficulty of the task ahead; however, the desire for expediency should not overshadow the fundamental differences inherent in the business structures.

As such we are particularly concerned that in trying to fulfill their obligations, particularly as it related to international banking standards under Basel III, the Federal Reserve proposed new capital rules for all banks, BHCs, and SLHCs. The June 7th proposed rules represent a one-size fits all approach that simply does not make sense for an SLHC engaged predominantly in the business of insurance.

The application of these capital requirements to mutual insurance SLHCs will have many significant consequences. It will require many mutual insurers to adopt new accounting practices. It will not fully recognize forms of capital that state insurance regulators have recognized for more than a century, like surplus notes. It will result in unintended and unwarranted differentiation between stock and mutual insurers who own banking organizations. And it will result in significant disruption in business functions in advance of the 2013 effective date of the rules. This is obviously not a consequence that Congress intended.

Under DFA, as passed by Congress, more time for the transition for SLHCs could have been provided, but the Federal Reserve chose to start the implementation process for all banking organizations in 2013. In comparison, when Basel I capital requirements were initially proposed in 1989, banks and their holding companies, who were already subject to Federal Reserve capital requirements and already under GAAP accounting, were given three years to comply with the new capital structure.

We will urge the Federal Reserve to consider accepting equivalence of the capital standards required by state regulators. If they must have a one-size-fits-all capital process then at a minimum they should allow the full three years for insurance-connected SLHCs to adopt new accounting practices and adjust to the new bank-centric requirements. At a bare minimum the Federal Reserve needs to provide more time for all interested parties to assess the proposed capital requirements and provide well-researched comments applicable to the proposed rule.

We consider it a good sign that while testifying before Congress last week, Chairman Ben Bernanke indicated that the Federal Reserve would work to recognize the differences between insurance and banking holding companies. In this light, we believe the Federal Reserve should recognize state risk-based capital models as providing a foundation that can be deemed sufficient to satisfy the minimum risk-based capital and leverage requirements of the Collins Amendment.

Systemic Risk

Throughout the debate on regulatory reform, we have consistently pointed out that traditional property/casualty insurance products and services do not pose systemic risk and the legislative history of the DFA is unambiguous that Congress agreed with us on this point. However, we continue to face challenges from federal regulatory agencies attempting to establish bank-centric standards and thresholds, which could inappropriately result in the designation of an insurer as systemically significant.

The DFA tasks the Financial Stability Oversight Council ("FSOC") with identifying those financial institutions that might pose a systemic risk to the U.S. economy. Any company – including non-bank financial institutions such as insurance companies – that is designated by the FSOC as a Systemically Important Financial Institution ("SIFI") will be subject to heightened capital standards and regulation by the Federal Reserve. NAMIC worked with the FSOC to ensure that the six-category analytical framework - size, interconnectedness, lack of substitutes, leverage, liquidity risk and maturity mismatch, and existing regulatory scrutiny - takes into account insurance specific standards and regulatory structures. While we were generally pleased with the final criteria, we note that the FSOC rejected an industry wide exception for insurance companies.

However, the Federal Reserve recently proposed a regulation to apply those same SIFI standards to any banking organization with over $50 billion in assets and with substantial banking activities, regardless of FSOC designation. NAMIC believes that this arbitrary numerical threshold set by the Federal Reserve is contrary to congressional intent and ignores the unique nature of certain financial products,

including property/casualty insurance. The application of heightened capital standards – again, designed with banks in mind – to insurance companies would be unnecessary and inappropriate.

We are concerned also about the confidentiality of information submitted during the designation process. The final rule indicates that information collected, from whatever source, during FSOC's analysis is subject to the Freedom of Information Act (FOIA), including its exceptions. The rule further states that submission of privileged materials to the FSOC does not waive any applicable privilege, but we remain concerned, absent statutory support, that this may not provide adequate protection. For example, the Federal Deposit Insurance Act provides for such protection for materials provided to enumerated federal bank regulatory agencies. The FSOC, however, is not among those enumerated entities. The CFPB recently attempted to address concerns by promulgation of a rule asserting its ability to protect information it receives. In addition, NAMIC is concerned that members of the FSOC may share information among themselves that is derived from their respective agencies and elsewhere. Although the protection from public disclosure of such materials is intended to travel with the materials, the FSOC members may share the information with their own agencies for enforcement or other purposes, thus expanding the use of such materials for other purposes. NAMIC supports passage of H.R. 4014/S. 2099 to ensure that information submitted to the CFPB remains privileged under both the attorney-client and work product privileges as well as other protections that would guarantee that materials are used only for the intended regulatory purpose, not released and that the documents retain their attorney-client and work product privileges.

Resolution Authority

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. The state-based guaranty fund system is designed first and foremost to protect policyholder and third-party claimant interests. Each state provides for priority of these claims over other unsecured general creditor claims. In addition, unlike federal resolutions of banking interests, insurance company resolutions require adjustment of property/casualty insurance claims dependent on state law and requiring detailed and specialized knowledge.

Subjecting insurance companies, including mutual insurance holding companies, to federal resolution would disrupt this well-functioning system. Overlaying federal resolution would needlessly complicate the process and likely disadvantage policyholders and claimants. NAMIC is pleased that the Federal Deposit Insurance Corporation recognized the strength of the state-based resolution system and clarified that insurance operations will be resolved under state insolvency laws. Further, NAMIC believes that the FDIC properly recognizes mutual insurance holding companies as insurance companies. Such treatment is consistent with legislative intent and best serves insurance policyholders and claimants. The proposed criteria are appropriate to identify a *bona fide* mutual insurance holding company and consistent with the goal of

conforming state resolution authority for insurance companies with the resolution authority of the holding company.

There is still significant concern that any company above $50 billion in assets – including mutual holding companies or SLHCs could be subjected to an assessment in the event that a federal bailout is needed to unwind a SIFI after failure. This also raises the concern about the appropriate assessment base. Any base used for all financial institutions will need to address the differences in financial structure between banks and insurance entities. More fundamentally, subjecting insurance companies to an assessment to pay for a mechanism that they will not need or likely ever make use of would be inherently unfair.

Accounting Standards

Of particular concern to insurers is the ability to prepare financial statements in accordance with Statutory Accounting Principles ("SAP"). State regulators – and previously the OTS – accept and use SAP financial statements as opposed to requiring such statements be prepared using Generally Accepted Accounting Principles ("GAAP") for both subsidiary and holding company reporting purposes. Switching the type of reporting from SAP to GAAP for those holding companies regulated by the Federal Reserve either because of bank-oriented reporting forms or due to international pressure is simply not justified by the resulting costs and burdens that would be imposed on companies.

All insurance companies in the United States are required for state regulatory purposes to report based on SAP (publicly held insurers are also required to report on a GAAP basis). The important difference between GAAP and SAP is the purpose of each system. One of the primary objectives of GAAP accounting is to provide important financial information to the investing community to make informed decisions on a going concern basis regarding whether to invest in publicly traded companies. In contrast, SAP reporting was designed from the outset with a solvency focus and regulatory purposes in mind (monitoring for solvency and financial soundness) and has a long history of highly effective use in the insurance sector. It provides appropriately conservative measures of insurance assets and liabilities. The use of SAP is codified in all states because its more conservative approach in assessing an insurance company's solvency and ability to pay claims, and meet its obligations is the very foundation of financial entity regulation. SAP is also well recognized within the accounting profession as an Other Comprehensive Basis of Accounting ("OCBOA") and like GAAP, also allows for audited financial statements.

Most important from our perspective is that numerous non-publicly traded insurers, such as mutual insurance companies, use SAP exclusively or use GAAP only on a limited basis. Consequently, if the Federal Reserve requires the application of consolidated GAAP-based accounting solely for purposes of reporting on the FR Y-9, the transitional costs will be extraordinary, requiring changes in accounting systems, internal control systems, and training of personnel, thereby creating significant burdens without

providing any appreciable benefit in meeting the regulatory goals of safety, soundness, and identifying risks in the holding company. Furthermore, although the burdens are significant for both small and large insurers, they would be particularly acute in instances where the thrift is a relatively small component of the larger insurance holding company and further amplified in large insurance companies with relatively small thrifts. Finally, the significant costs associated with implementing GAAP solely for SLHC reporting purposes, would not obviate the need to continue preparing reports on a SAP basis, which would have to be continued for state regulatory purposes.

Given these considerations, NAMIC does not believe any perceived benefits to the Federal Reserve or to companies in mandating the use of GAAP are justified by the costs. Furthermore, a SAP based reporting requirement would better align with the needs and stated purpose of the Federal Reserve to determine the safety and soundness of the insurance-connected SLHC. The burdens associated with requiring GAAP-based reporting on SLHC's not otherwise required to produce consolidated GAAP statements would be significant and could have adverse consequences, particularly in instances in which very large insurance operating companies own relatively small thrifts.

Conclusion

It is clear that the property/casualty insurance industry plays a key role in the economy and every effort should be made to ensure that its markets are functioning. Unfortunately, even though the industry was not directly targeted, the DFA has created a large amount of potential market turmoil and uncertainty for insurers. NAMIC again thanks the committee for its careful attention to our concerns and for its continued scrutiny of the implementation of the DFA. As we move forward, we would urge Congress to rectify the unintended consequences that are inevitable in any legislative initiative of this size and scope. The focus should remain on preventing unneeded and damaging interference in a well-functioning system.

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

Robert P. Hartwig, Ph.D., CPCU

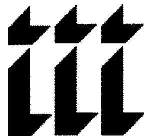
President & Economist

Insurance Information Institute

New York, NY

July 24, 2012

Washington, DC



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.

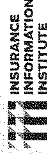
Other concerns voiced by some insurers include the possibility of "mission creep" by the newly created Consumer Financial Protection Bureau (CFPB), the eventual execution of subpoena authority granted to the new Federal Insurance Office, powers granted to the Federal Reserve following a Systemically 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.


INSURANCE
INFORMATION
INSTITUTE

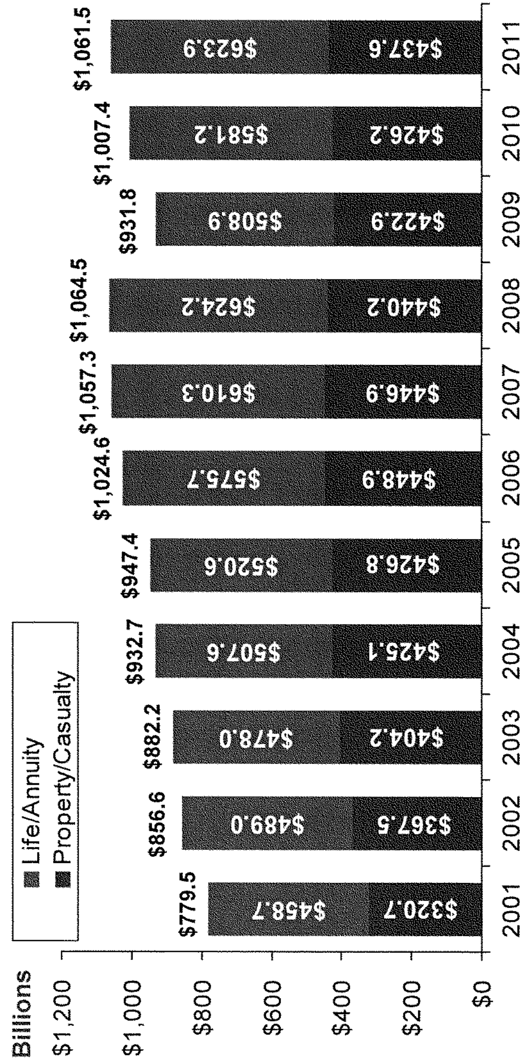
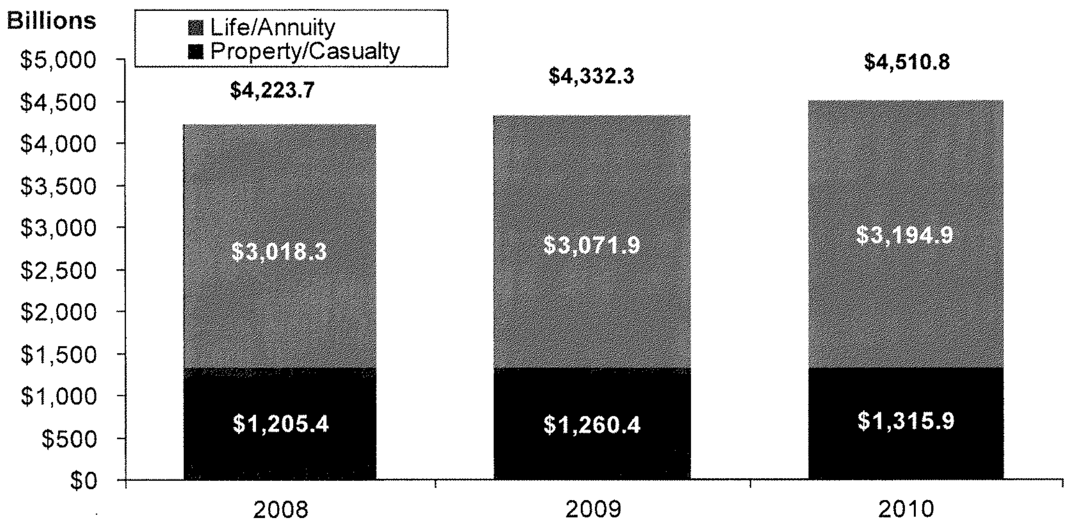


Exhibit 1
Insurance Industry Net Premiums Written, 2001-2011
Billions
Life/Annuity
Property/Casualty
$1,200
$1,000
$800
$600
$400
$200
$0
$779.5
$458.7
$320.7
$856.6
$489.0
$367.5
$882.2
$478.0
$404.2
$932.7
$507.6
$425.1
$947.4
$520.6
$426.8
$1,024.6
$575.7
$448.9
$1,057.3
$610.3
$446.9
$1,064.5
$624.2
$440.2
$931.8
$508.9
$422.9
$1,007.4
$581.2
$426.2
$1,061.5
$623.9
$437.6
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
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.
1

Exhibit 2

Insurance Industry Assets, 2008-2010

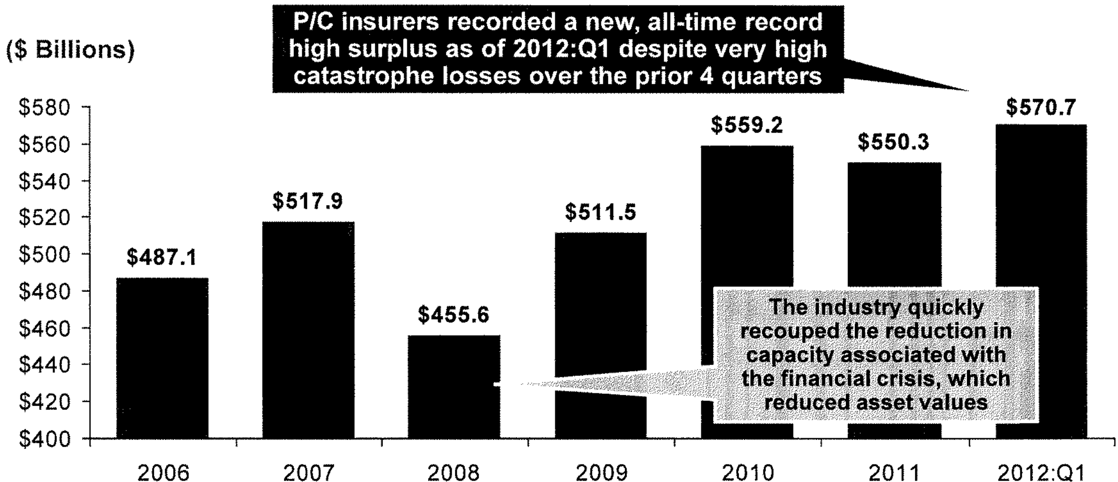


The combined assets of the property/casualty and life/annuity segments of the insurance industry totaled $4.51 trillion as of year-end 2010. Despite a difficult economic and financial market environment, total assets are up by nearly $300 billion since 2008.

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

Exhibit 3

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

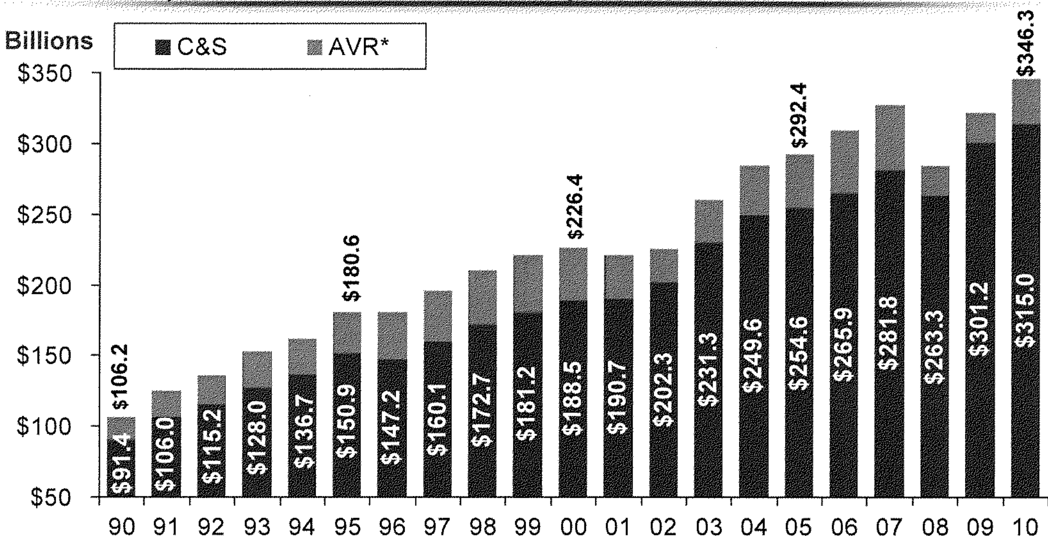


Property/Casualty insurer policyholder surplus is effectively the industry's net worth and represents the industry's claims paying capacity and is a proxy for the supply of insurance available in the market.

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

Exhibit 4

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



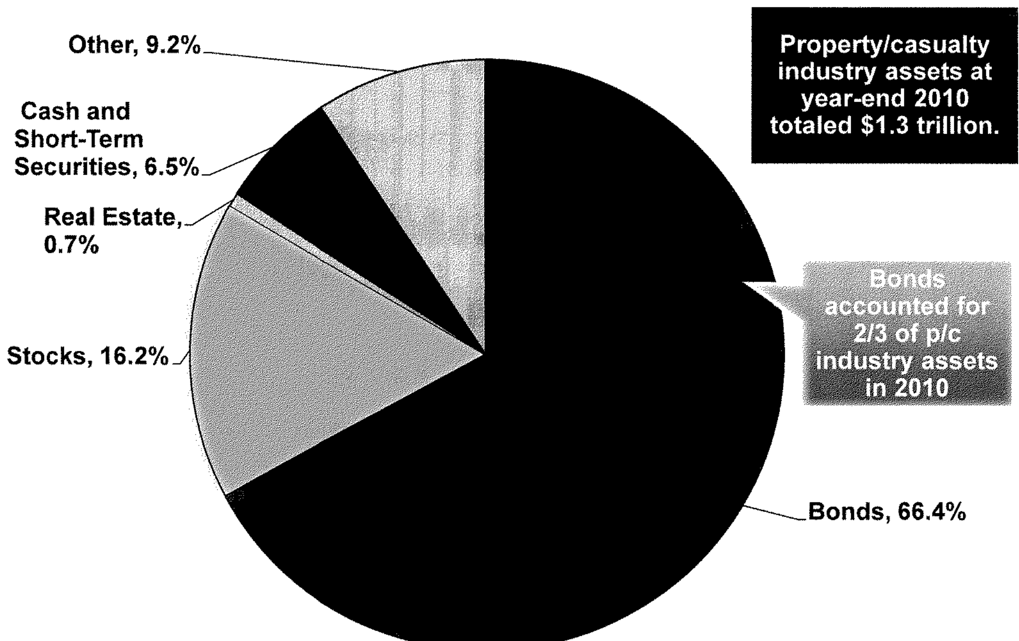
The Capital & Surplus (C&S) Account of Life/Annuity insurers has generally been increasing over time. The Asset Valuation Reserve (AVR), booked as a liability, is essentially an additional surplus account to "cushion" asset value drops. The industry has remained strong despite a challenging economic/financial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

*Prior to 1992, this was the Mandatory Securities Valuation Reserve (MSVR)
Sources: ACLI 2011 Life Insurance Fact Book; Insurance Information Institute.

4

Exhibit 5

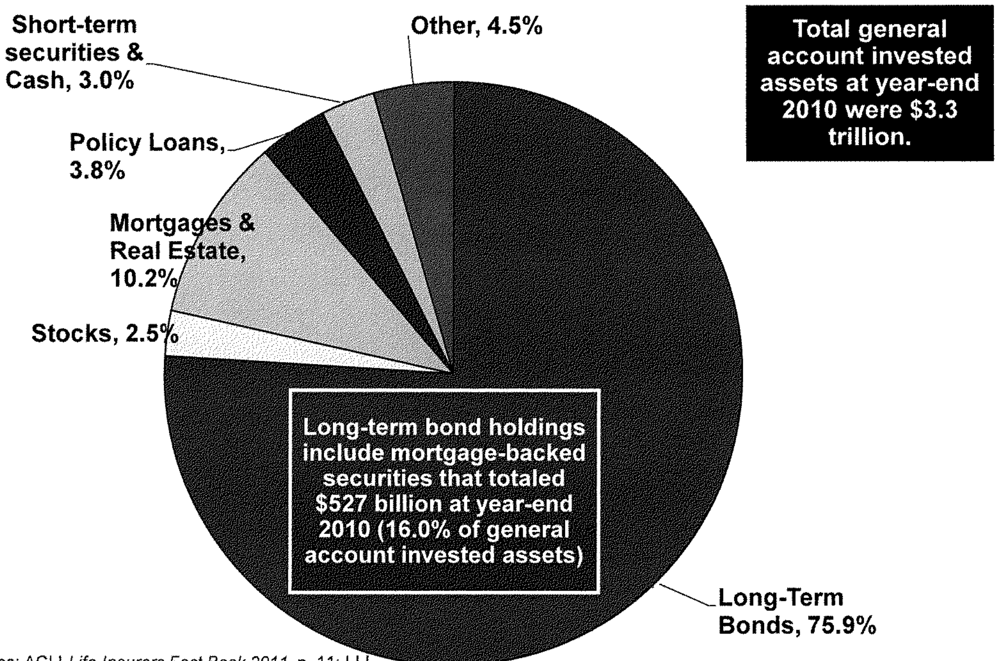
Distribution of Property/Casualty Insurer Invested Assets, 2010



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

Exhibit 6

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



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

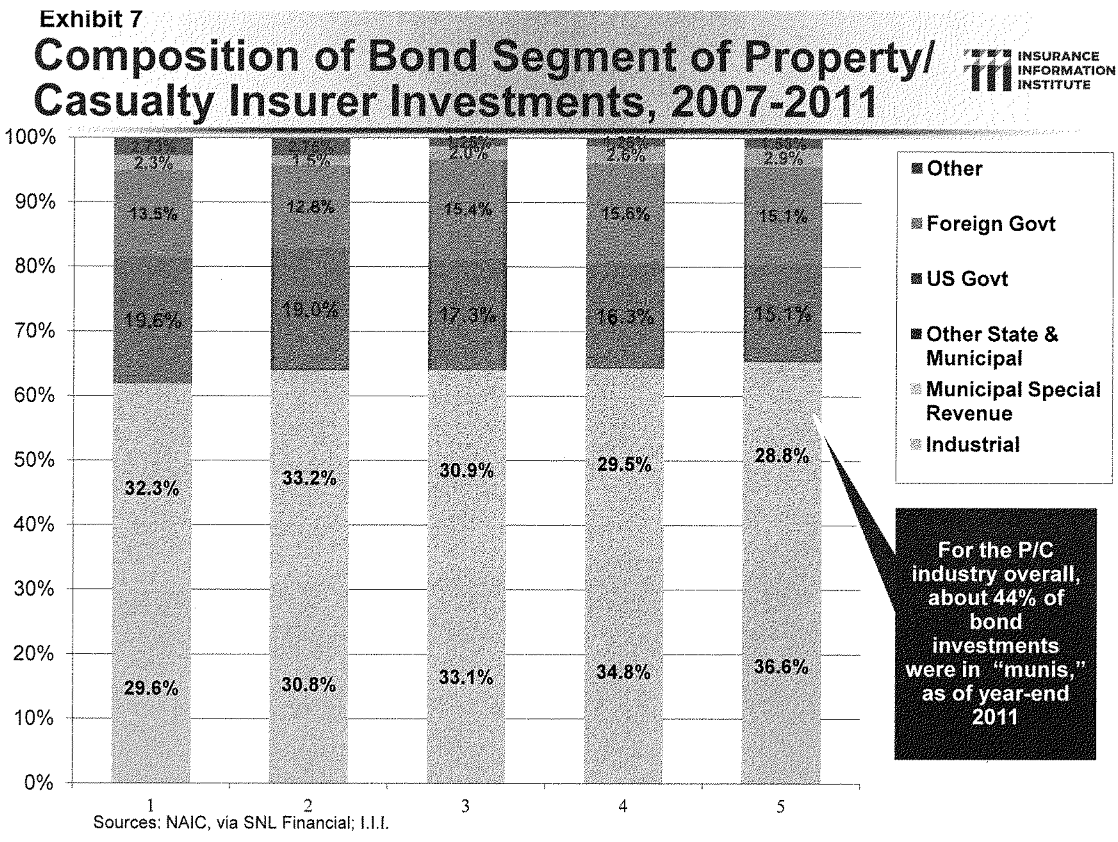


Exhibit 7
Composition of Bond Segment of Property/ Casualty Insurer Investments, 2007-2011
INSURANCE INFORMATION INSTITUTE
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
2.3%
1.5%
2.0%
2.6%
2.9%
13.5%
12.8%
15.4%
15.6%
15.1%
19.6%
19.0%
17.3%
16.3%
15.1%
32.3%
33.2%
30.9%
29.5%
28.8%
29.6%
30.8%
33.1%
34.8%
36.6%
1
2
3
4
5
Other
Foreign Govt
US Govt
Other State & Municipal
Municipal Special Revenue
Industrial
For the P/C industry overall, about 44% of bond investments were in "munis," as of year-end 2011
Sources: NAIC, via SNL Financial; I.I.I.

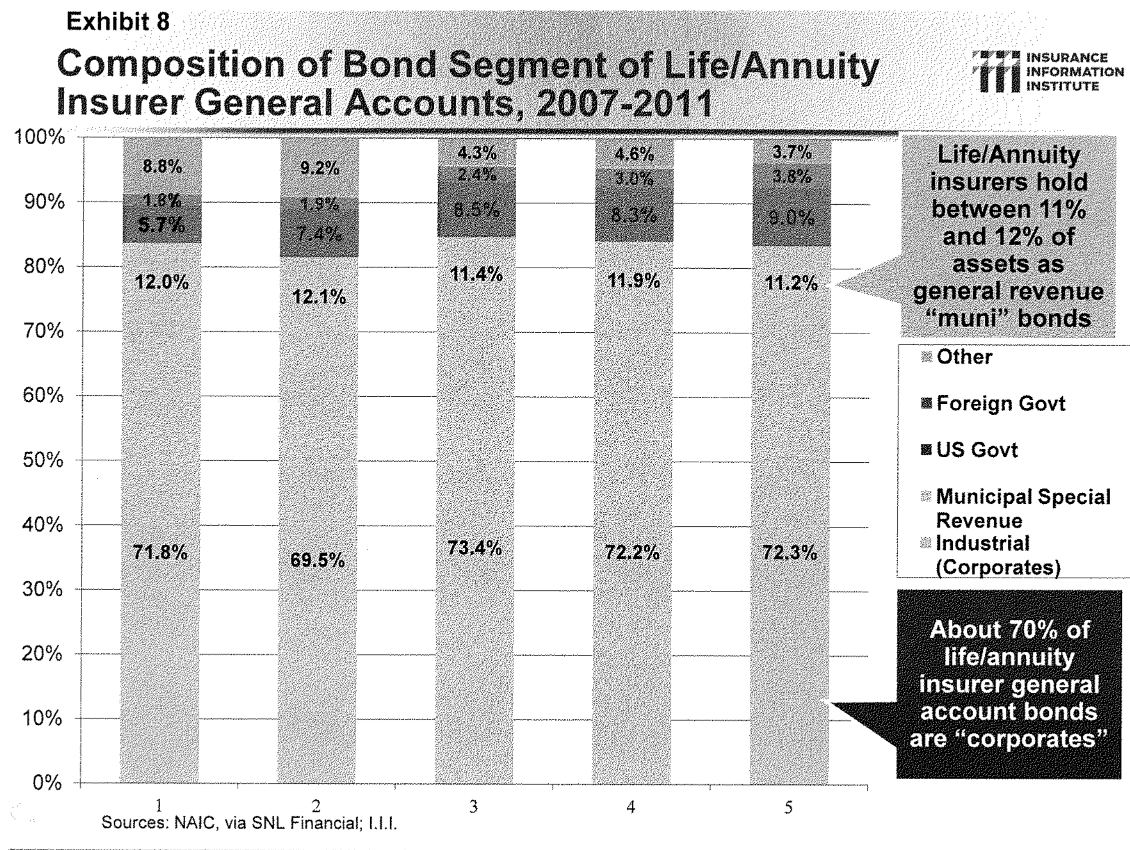
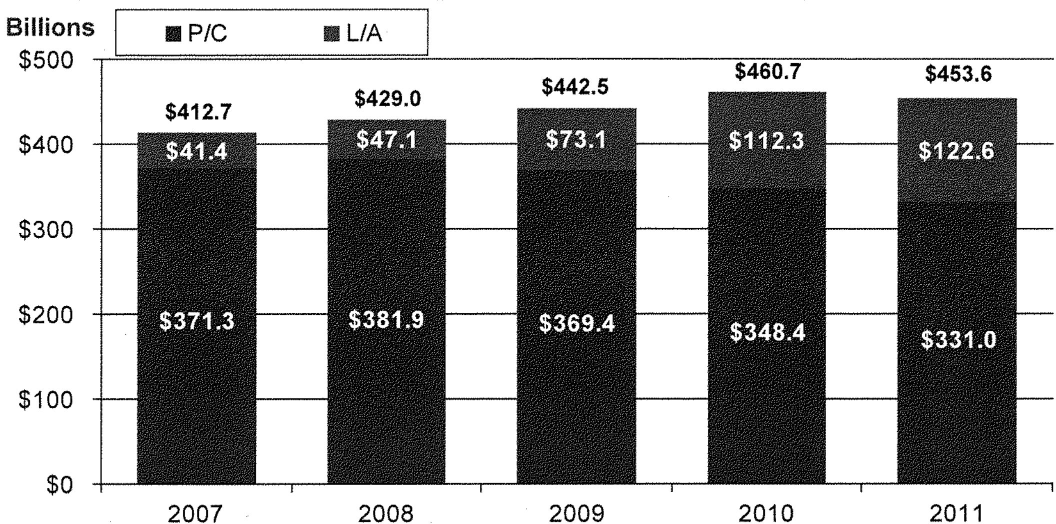


Exhibit 8
Composition of Bond Segment of Life/Annuity Insurer General Accounts, 2007-2011
INSURANCE INFORMATION INSTITUTE
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
8.8%
1.8%
5.7%
12.0%
71.8%
9.2%
1.9%
7.4%
12.1%
69.5%
4.3%
2.4%
8.5%
11.4%
73.4%
4.6%
3.0%
8.3%
11.9%
72.2%
3.7%
3.8%
9.0%
11.2%
72.3%
1
2
3
4
5
Sources: NAIC, via SNL Financial; I.I.I.
Life/Annuity insurers hold between 11% and 12% of assets as general revenue "muni" bonds
Other
Foreign Govt
US Govt
Municipal Special Revenue
Industrial (Corporates)
About 70% of life/annuity insurer general account bonds are "corporates"

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

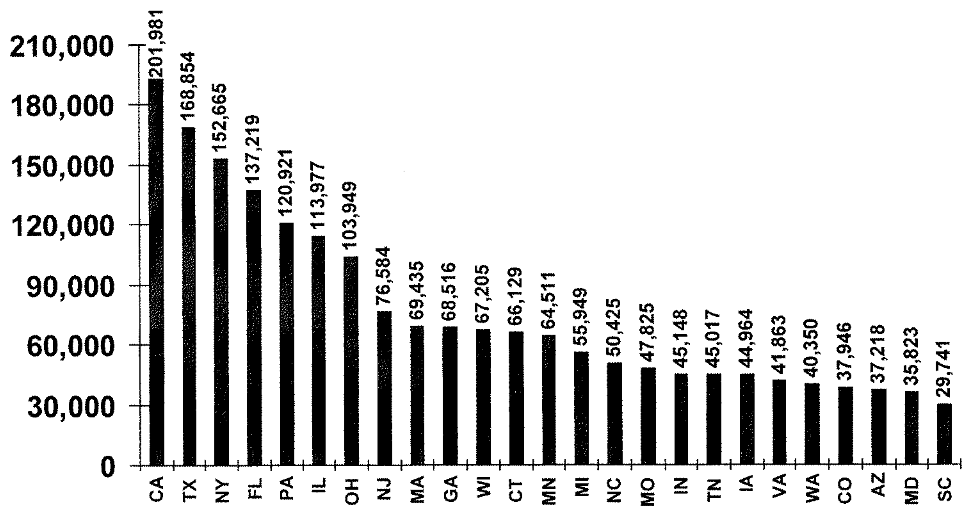
Overview of Insurance Sector Employment Changes*

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)



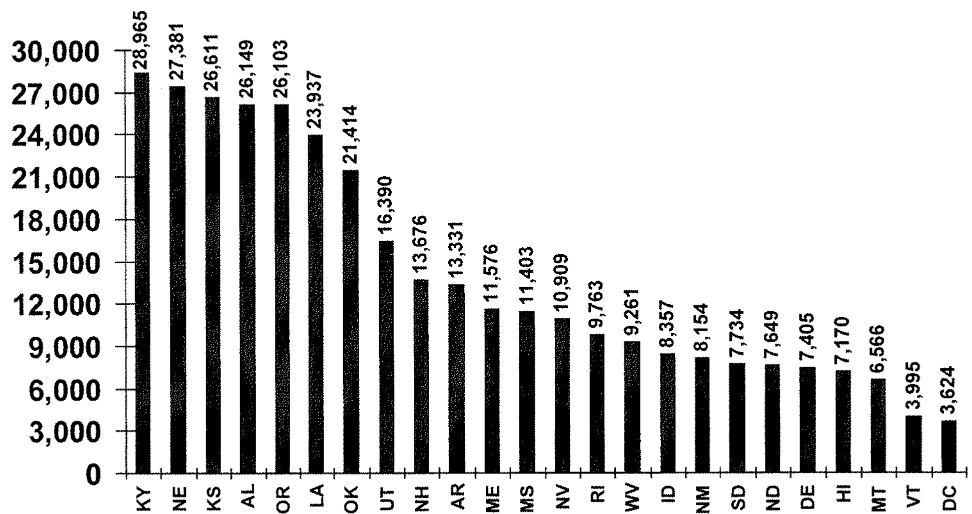
(1) The estimates for Alaska and Wyoming are not shown to avoid disclosure of confidential information..

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.

Exhibit 11, Page 2

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



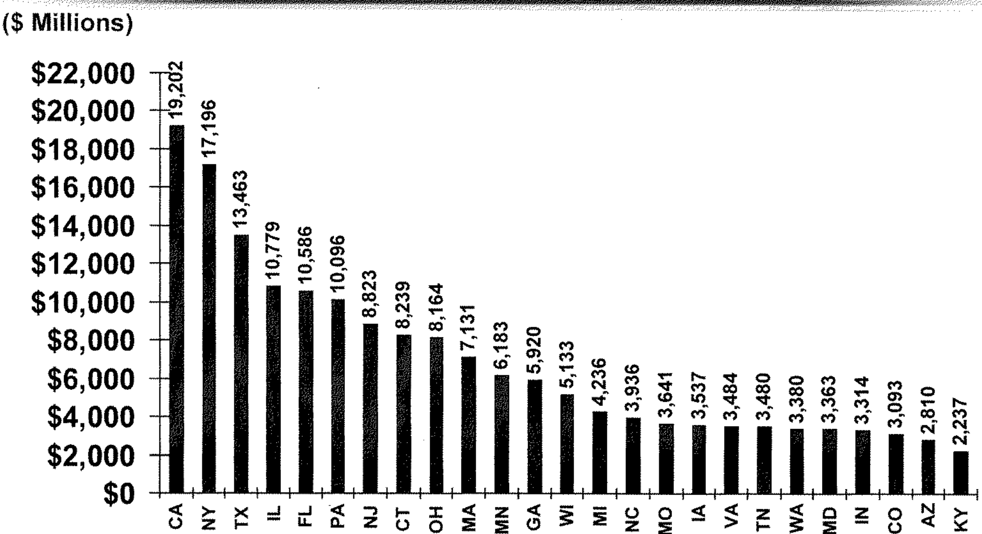
(1) The estimates for Alaska and Wyoming are not shown to avoid disclosure of confidential information.

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.

Exhibit 12, Page 1

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



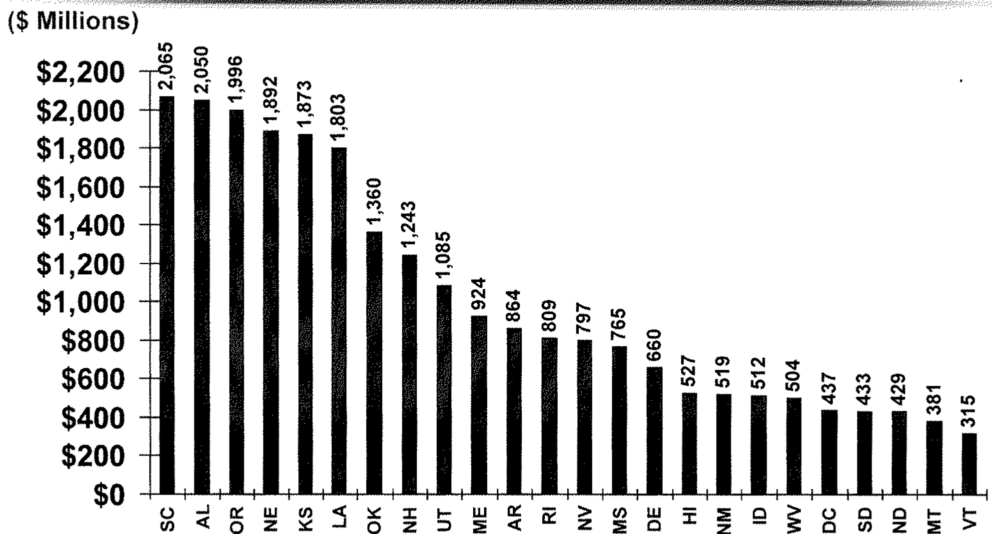
(1) The estimates for Alaska and Wyoming are not shown to avoid disclosure of confidential information..

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

Exhibit 12, Page 2

INSURANCE INFORMATION INSTITUTE

Insurance Carriers and Related Activities Compensation by State, 2010: Lowest 24 States (1)



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

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

100 Years Standing Up for American Enterprise

U.S. CHAMBER OF COMMERCE

Statement of the U.S. Chamber of Commerce

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

TO: The Subcommittee on Insurance, Housing and Community Opportunity

DATE: July 24, 2012

The Chamber's mission is to advance human progress through an economic, political and social system based on individual freedom, incentive, initiative, opportunity and responsibility.

The U.S. Chamber of Commerce is the world's largest business federation, representing the interests of more than 3 million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations.

More than 96 percent of the Chamber's members are small businesses with 100 or fewer employees, 70 percent of which have 10 or fewer employees. Yet, virtually all of the nation's largest companies are also active members. We are particularly cognizant of the problems of smaller businesses, as well as issues facing the business community at large.

Besides representing a cross-section of the American business community in terms of number of employees, the Chamber represents a wide management spectrum by type of business and location. Each major classification of American business -- manufacturing, retailing, services, construction, wholesaling, and finance – is represented. Also, the Chamber has substantial membership in all 50 states.

The Chamber's international reach is substantial as well. It believes that global interdependence provides an opportunity, not a threat. In addition to the U.S. Chamber of Commerce's 115 American Chambers of Commerce abroad, an increasing number of members are engaged in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Positions on national issues are developed by a cross-section of Chamber members serving on committees, subcommittees, and task forces. More than 1,000 business people participate in this process.

Chairman Biggert, Ranking Member Gutierrez, and members of the Insurance, Housing and Community Opportunity Subcommittee, I am Thomas Quaadman, vice president of the Center for Capital Markets Competitiveness at the U.S. Chamber of Commerce. The Chamber is the world's largest business federation, representing the interests of more than three million businesses and organizations of every size, sector and region. I appreciate the opportunity to testify before the Subcommittee today on behalf of the businesses that the Chamber represents.

The series of hearings this month, by the Financial Services Committee and its Subcommittees, on the second anniversary of the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), provide us with an opportunity to take stock of the framework and progress of this landmark legislation. Much of the testimony provided during these hearings has focused on what the Dodd-Frank Act does or intends to do. While I will get to the impacts of the Dodd-Frank Act particularly upon the insurance and business community in a minute, I do want to spend some time discussing what the Dodd-Frank Act does ***not*** do.

The need for financial regulatory reform was apparent before the 2008 financial crisis. Over the last decade it became evident to many observers that the U.S. capital markets, the deepest and most efficient in world history, were slowly but consistently losing their edge. This was making it more difficult and expensive for businesses to raise the capital needed to grow and create jobs. In 2006, the Chamber formed a bi-partisan commission headed by Bill Daley and A.B. Culvahouse to research the problem. After a year, they came back with two conclusions: 1) that our international competitors were competing using our game plan—not a bad thing; and 2) that our financial regulatory structure, which dates from the New Deal and in some cases as far back as the Civil War, was ineffective, overly complicated, and inadequate to deal with a 21st century economy. Others, from Mayor Michael Bloomberg and Senator Charles Schumer to Harvard Professor Hal Scott, reached similar conclusions at around the same time.

Such an antiquated, static system froze regulators' capabilities at the time they were created or endowed with their powers. At best, regulators were trying to regulate 2007 markets with 1975 regulatory tools. As a result, regulators had not kept pace with and did not understand the markets or products that they were trying to regulate. This led to confusion amongst regulators, turf battles, regulatory gaps and dead-zones, layering of rules, and a difficulty for regulators to deal with cross-border issues on an international basis. As was evidenced by the Madoff and Stanford cases, regulators could not spot the bad guys and drive them out of the markets.

In short, businesses did not have clear rules of the road, regulators were inconsistent in enforcing those rules, and bad actors were not found or punished. This was not a formula for success.

Common sense solutions—streamlining the number of regulators, hiring the expertise needed to understand the markets, making the regulators accountable, forward looking regulation—were not considered in the Dodd-Frank debate. Instead, Dodd-Frank creates more regulators, exponentially increases layering and overlap, and does not hold regulators accountable. The Dodd-Frank Act adds more floors to a building sitting on a crumbling foundation.

In a sense, the Dodd-Frank Act tries to super-size the 1975 system while the regulators should be thinking on how the markets will look in 2020.

MF Global and Peregrine are just the latest indicators that the underlying foundational issues remain. Because of the failure to address these underlying issues and the regulatory explosion under the Dodd-Frank, our financial regulatory structure is in danger of becoming even more inefficient, while constraining the ability of non-financial businesses to grow and thrive. Simply, we may be in danger of jumping from crisis to crisis with a sluggish economy to boot.

The financial services industry is a conduit to provide a transfer of capital from investors to businesses. Unreasonably restricting that conduit affects the ability of businesses to tap the capital they need to operate and grow. Our economy is in fact a rich and diverse mosaic with no one part being the same as another.

The insurance industry is a unique and important part of that mosaic.

The insurance industry is one of the largest investors in the world. Insurance companies can be direct investors in companies through the purchase of bonds or equity instruments, or they can invest in entities that support businesses, such as commercial real estate. Furthermore, because of the insurance industry's need to match its investment portfolio to the very long-term nature of many of its products, it is by nature and necessity a long-term investor committed to the long-term growth and productivity of the companies or products in its asset portfolio. As a result, it is in the best interests of insurers to be extremely prudent in their risk taking.

Therefore, insurers, besides the risk management services they provide to their customers, are a critical piece of the capital markets. Insurers are a key provider of capital for the long-term. Consequently, the potential adverse impacts of the Dodd-

Frank Act upon the insurance industry's ability to act as an investor will have serious consequences for Main Street businesses.

Dodd-Frank also has consequences unique to the insurance industry. Asset liability management for insurers is by its very nature a form of proprietary trading. While this trading is done for the benefit of the insurance company, the ultimate beneficiaries are the policy holders who will receive the benefits of coverage should the underlying circumstances—a car accident, home fire, loss of income due to death or disability—arise. Congress recognized this issue and wisely provided insurance companies with an exemption from the Volcker Rule.

However, as Dodd-Frank gives with one hand it also takes away with the other.

Insurers that own banks are not exempt from the Volcker Rule. Insurance companies may own a bank for a variety of reasons—like lowering transaction costs or providing additional services to customers. Several insurance companies have already spun off their banks to avoid being entrapped in the Volcker Rule. So while these insurance companies do not engage in the type of proprietary trading envisioned by the Volcker Rule and were intended to be exempted by Congress, they are still forced to make business decisions based upon regulatory interpretations that make them less efficient.

Even if insurance companies are completely exempt from the Volcker Rule, the subjective trade by trade regulatory scrutiny of market making and underwriting practices may make it more difficult for insurance companies to play their traditional role in the debt and equity markets. This will make risk management more difficult for insurance, while reducing the capital formation opportunities and increasing the costs for non-financial companies. This is not an unfounded fear. Federal Reserve Governor Daniel Tarullo testified before the House Financial Services Committee on January 18, 2012, months after the Volcker Rule regulations were proposed, and said that the regulators do not understand what normal market making and underwriting practices are.

If regulators don't know what they are regulating, how can they write a regulation? Therefore, through enforcement or by decision, market participants such as insurance companies may be shut out of traditional investment opportunities or face higher costs and regulatory scrutiny.

Another quandary for regulators and the insurance industry is the designation and regulation of Systemically Important Financial Institutions (SIFIs).

While the vast majority of insurance companies will not fall within the scope of systemic risk regulation and orderly liquidation authority in Title I and Title II, it is worth noting that such a designation would be problematic for insurance companies.

The Federal Stability Oversight Council has finalized regulations laying out the process for designation of nonbank SIFIs. While these regulations provide some insight into the process of being designated as a SIFI, they provide no clarity on the impact of that designation in the marketplace. The Treasury and the Federal Reserve continue to offer no assurance or insight on the market impact on the companies designated as SIFIs, and maybe more significantly, the impact on those companies not designated.

What is clear is that designation brings significant new regulation and supervision of nonbank SIFIs by the Federal Reserve. SIFI regulation and Orderly Liquidation Authority are bank-centric and fail to take into account the different business models that exist within the non-bank world and the insurance industry specifically. For instance, because insurers' liabilities are contingent, runs on capital are not possible, making insurance a major stabilizing force in times of economic distress. Moreover, insurers are typically leveraged at a ratio of around 3-to-1, much lower than that of the banks upon which the rules were formulated. The imposition of bank-centric regulation could cause regulatory mismatches that may conflict with insurance regulations that have been developed for well over 150 years. Regulatory conflicts of this nature will increase risk within the industry rather than temper it.

The Federal Reserve should propose and adopt regulations that are specifically written for the supervision of nonbank financial companies that are designated as SIFIs, including insurance companies. Its current approach of simply applying the same Enhanced Prudential Standards and "tailoring" the application of those rules during the supervision process is unwise and insufficient. It creates unnecessary uncertainty for the regulated entities and potential market distortions. The Federal Reserve can avoid these problems by taking the time to understand how the business models and operations of insurance companies and other nonbank financial companies differ from banks and issuing regulations with the opportunity for public input that reflects these differences. This is too important not to get right at the start.

Through its use of assessments, Orderly Liquidation Authority will spread the risk of a systemically risky company going out of business upon all designated companies. This is the traditional means of dealing with a bank failure, part of which also allows the merger or combination of a failed bank with a solvent bank. So while banks bear the costs, they also have the potential for opportunities that may be profitable.

Traditionally with non-financial companies and insurance, it is the owners of the companies that bear the risk of loss. If those owners and managers no longer solely hold that risk, will a systemic risk designation make them more willing to engage in risky behavior placing their competitors at a disadvantage? This is a known unknown at this point, but one that may be terribly harmful when the answer presents itself in the future.

Also, systemic risk regulation is being implemented globally as well as domestically, in two separate and uncoordinated processes, following different standards with potentially different outcomes. An insurer deemed not systemically risky under the domestic process may still find itself designated under the international process. Moreover, if domestic and international designations carry with them conflicting systemic risk rules, which regulatory regime prevails? Insurance companies designated as systemically risky will bear the brunt of the state regulatory system, domestic systemic risk regulation and international systemic risk regulation. This is not only burdensome and expensive, but it may lead to irresolvable dilemmas that place the company at legal and financial risk.

It should also be understood that these Dodd-Frank regulatory changes and consequences are not happening in a vacuum. The insurance industry is also facing other major regulatory changes including possible new domestic and international accounting standards, the imposition of bank-centric capital levels under Basel III, and the negotiation of Solvency II. Regulators have not taken into consideration the cumulative impacts of all of these initiatives, yet it is their interconnected nature that will determine how the insurance industry and economy will operate.

Failing to get this right will harm the insurance industry and American capital markets for the next generation.

Finally, the Chamber has supported the creation of the Federal Insurance Office. This allows the American insurance industry to have a unified governmental entity in the negotiation of international agreements.

The drafters of the Dodd-Frank Act sought to reduce risk following the 2008 financial crisis. However, risk, like energy, cannot be destroyed -- it can only be transferred. Reasonable risk taking is at the heart of our free enterprise system and to eliminate risk will also eliminate the entrepreneurial spirit that allows our economy to constantly renew itself and dynamically create wealth and jobs. Blindly transferring risk, without the requisite streamlining and reform of the antiquated 19th and 20th century financial regulatory structure, is merely fighting the last battle of the last war and planting the seeds for the next crisis.

In reviewing the Dodd-Frank Act two years later, policy makers must take into account the impacts upon the capital formation for the non-financial industry and ameliorate negative impacts. Failing to do so will consign the economy to anemic growth and the United States will not be able to create the 20 million jobs over ten years needed for a prosperous economy.

To date, nearly 10 different regulatory bodies have issued almost 9,000 pages of regulations, and that only completes 30 percent of the regulations mandated by the Act. No one knows the full implications of these new regulations on our economy. However, there can be little doubt that the burden and uncertainty of these new regulations will be a drag on our economy and job growth for years.

Thank you and I will be happy to take any questions that you may have.

Financial Security...for Life.

American Council of Life Insurers (ACLI) Statement for the Record
House Financial Services Committee
Subcommittee on Insurance, Housing, and Community Opportunity
Hearing entitled "The Impact of the Dodd-Frank's Insurance Regulations on Consumers, Job Creators, and the Economy"

July 24, 2012

The American Council of Life Insurers (ACLI) is pleased to submit this statement for the hearing record expressing the concerns of the life insurance industry about implementation of certain provisions of the Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act).

The American Council of Life Insurers is a Washington, D.C.-based trade association with more than 300 legal reserve life insurer and fraternal benefit society member companies operating in the United States. ACLI advocates in federal, state and international forums. Its members represent more than 90 percent of the assets and premiums of the U. S. life insurance and annuity industry. In addition to life insurance, annuities and other workplace and individual retirement plans, ACLI members offer long-term care and disability income insurance, and reinsurance. Its public website can be accessed at www.acli.com.

Federal Reserve Board Supervision & the Collins Amendment

Through authorities provided in the Dodd-Frank Act, the Federal Reserve Board (FRB) regulates at the holding company level a number of companies that are primarily life insurers. The Dodd-Frank Act granted the Federal Reserve Board (FRB) new supervisory authority over savings and loan holding companies (SLHC's), many of which are, or own, life insurers. The FRB recently exercised these new authorities, issuing three proposed rules on June 7 which collectively implement Basel 3 capital standards and Section 171 of the Dodd-Frank Act (the Collins Amendment). The ACLI is very troubled by the June 7 rulemaking, which applies bank-centric standards and methodologies to insurance companies.

Life insurance companies, including those organized as savings and loan holding companies, are vastly different than banks. ACLI believes that any capital standards established under section 171 must recognize the fundamental differences between life insurance companies and banking organizations. Capital standards appropriate for banks are not appropriate for life insurers. Insurer risk-based capital (RBC) requirements are the appropriate prudential standards to apply to an insurance company.

Unlike banks, life insurers assume extensively underwritten long-term risks and acquire an asset mix intended to reflect the characteristics of those risks. In other words, the nature of the liabilities drives the nature of the assets purchased in support of those liabilities. A large portion of life insurer liabilities do not have an immediate call capability by the contract holder (or have protection features built into the contract), making it very unlikely that an insurer would experience a "run on the bank" liquidity scenario in times of stress.

State insurance regulators have long recognized the difference in business models between banks and insurers. Life insurers' investment portfolios are extensively regulated and are governed by state insurance law to ensure that investments are proper for the business of life insurance. Life insurer risk-based capital (RBC) charges are designed to measure asset default risk over extended periods of time for the types of investments that insurers own. These laws and regulations have been specifically designed for life insurers to ensure that the liabilities that have been assumed by the insurer will be covered by adequate assets when they come due.

Designation of Nonbank Financial Companies as Systemically Important

The Dodd-Frank Act also authorized the FRB to supervise nonbank financial companies designated as systemically important by the Financial Stability Oversight Council (FSOC). The FRB is authorized to establish enhanced prudential standards for these companies, some of which could be insurance companies.

The ACLI believes that the traditional activities of life insurance companies do not present a systemic risk to the financial stability of the United States. As noted above, life insurers do not depend on short-term, on-demand funding and are less susceptible to runs on their liabilities in times of distress. Furthermore, life insurance activities do not give rise to high interconnectedness with other financial institutions. Finally, the insurance regulatory system provides an established process for the orderly rehabilitation or wind-down of impaired life insurers that prevents "fire sale" liquidations.

In the event that the FSOC designates one or more life insurance companies as systemically important, ACLI believes, as stated above, that bank-centric capital and prudential standards are unworkable for insurers. Section 165 of the Dodd-Frank Act specifically requires the FRB to adapt prudential standards to the predominant line of business of a nonbank financial company. ACLI is very disappointed that the FRB proposed rule establishing enhanced prudential standards did not provide the industry specific tailoring required by the statute. ACLI encourages Congress to continue to exercise its oversight authority over the prudential regulators to ensure that the tailoring stipulated by Congress is implemented.

The Business of Insurance Exclusion to the Volcker Rule Should be Preserved in Full

Congress recognized the unique nature of insurance companies in the Dodd-Frank Act by establishing the "business of insurance" exclusion to the Volcker Rule. Unlike nearly all other financial institutions, insurers are predominantly focused on the long term. Insurers must manage the policy premiums and investments entrusted to them by their customers to meet obligations to those customers over multiple decades. The fundamental business model of an insurance company does not involve engaging in high risk or short term profit seeking.

Insurance company investment activities are subject to rigorous oversight and examination by state insurance regulators. State insurance regulators establish conservative limits on the percentage of assets that an insurer may invest in equities and generally require further limitations on investments in non-exchange traded equity investments. State regulators have comprehensive regulatory and reporting regimes for examining an insurer's investment activities and guarding against excessive risk in their investment portfolios.

If prudential regulators circumscribe the insurance exclusion by disallowing investments in covered funds, it would limit insurers' ability to earn the investment returns that support the guarantees made to policyholders. ACLI believes that any final rulemaking must follow Congressional intent and preserve in full the business of insurance exclusion to the Volcker Rule.

FDIC Orderly Liquidation Authority Legislation

The ACLI supports legislation which would exclude insurance companies from the Federal Deposit Insurance Corporation's "orderly liquidation authority." As noted above, state guaranty associations already have in place effective rehabilitation and liquidation processes for insurance companies that are designed to protect policyholders and minimize impacts on creditors. Life insurance companies are required to belong to the state guaranty associations in the states where they do business and may be assessed by those associations to meet the needs of policyholders in the event of another company's insolvency.

Thank you for convening this important hearing and for your consideration of the views of ACLI and its member companies.

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

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

Subcommittee on Insurance, Housing and Community Development
Committee on Financial Services
United States House of Representatives
July 24, 2012

The Property Casualty Insurers Association of America (PCI) commends the Subcommittee for holding this important hearing to examine the impact of the Dodd-Frank Act (DFA) on the insurance industry. PCI appreciates the opportunity to provide our thoughts on the Act's impact on the property casualty insurance industry in particular. PCI is composed of more than 1,000 member companies, representing the broadest cross-section of insurers of any national trade association. PCI members write over $189 billion in annual premium, 39.2 percent of the nation's property casualty insurance. Member companies write 45.5 percent of the U.S. automobile insurance market, 32 percent of the homeowners market, 37.3 percent of the commercial property and liability market, and 40.6 percent of the private workers compensation market.

Extensive post-crisis analysis by international and national insurance regulators and policy experts have consistently found that traditional insurance activities do not create systemic risk, did not cause the recent economic crisis, and that the U.S. industry generally has been and continues to be regulated successfully for solvency at the state level. Even after paying for two of the highest catastrophe loss years in history and suffering the greatest market crash in half a century, there were very few property casualty (P/C) insolvencies. The industry's credit ratings have remained stable and insurers' underwriting obligations are backed by historically strong surplus and surplus to premium ratios.

Home, auto, and business insurers generally present relatively low systemic risk because they generate relatively little counterparty risk and their liabilities in almost all cases are independent of economic cycles or other potential systemic failures. With respect to liabilities, P/C products tend to be mandatory with inelastic demand, so P/C revenues are relatively unaffected by outside systemic impacts. Recessions or third party failures do not significantly increase auto accidents, workers' injuries, or house fires. Insurance contracts are not typically subject to further hedging or risk arbitrage (unlike mortgage underwriting or financial guarantees that may be subjected to numerous cycles of securitization and further third party financial guarantees or risk betting). While some portions of primary risks are passed on to reinsurers, the risks are not further multiplied or leveraged, and the primary company almost always remains obligated and retains a portion of the underlying risk.

With respect to assets, P/C insurers do not hold other people's money, so there is no vulnerability towards a "run on the bank." Moreover, their underwriting obligations are supported by their own assets (unlike depository institutions, investment funds, or retirement accounts) as regulators permit less leveraging than for other insurance or financial companies. Ultimately, while the economy is highly dependent on the P/C industry, the industry's risks are independent and relatively walled off from systemic impairments.

For these reasons, DFA largely focused on other financial firms that pose far more systemic risk than insurers. Nevertheless, DFA did have some significant impacts on insurers, some of which were positive but some for which PCI recommends that the Subcommittee consider legislative remedies.

The Subcommittee should monitor carefully all DFA regulatory developments affecting insurers (as indeed it is doing through this hearing) to avoid unjustified, costly, and duplicative insurance regulatory requirements. It is important to remember that regulation carries costs – costs to government and costs to industries that must comply with government regulations. Average regulatory compliance costs grew 36% for small insurers from 2008-2010. By the third quarter of 2011, there were nearly 11,000 bills affecting insurers and 18,850 insurance statutes, regulations, and bulletins. With over 8000 pages of new regulations from DFA alone, insurers,

like other financial firms, are struggling to monitor, understand, and work towards compliance with all the new government mandates. For example, PCI has numerous insurance members with small thrifts that just received several hundred pages of proposed capital rules from the federal banking agencies. Just the management and legal staff required to understand these new rules is taking significant unmeasured time and resources away from new business and development and growth. These industry costs will inevitably have an impact on the cost of products for consumers and could also have a negative impact on employment in the insurance industry as well. Especially at this time, when our nation faces significant economic challenges and unacceptably high levels of unemployment, the Federal government should not increase economic burdens on consumers by imposing new financial regulatory burdens without demonstrating significant need or gaps.

Systemic Risk Determinations

DFA gave the Federal Reserve Board the power to impose heightened prudential standards on firms that the Financial Stability Oversight Council (FSOC) finds to be systemically risky. Because it is now well-established that traditional property casualty insurance activities are not systemically risky, Dodd-Frank should exempt such activities from federal systemic risk regulation. Nevertheless, we are pleased that the FSOC's final rule governing systemic risk determinations makes it relatively unlikely that companies predominantly engaged in the property casualty insurance business will be so designated. We are hopeful that the FSOC will continue to recognize the wisdom of that approach over time, but continue to believe that the statute should not grant FSOC the power to impose heightened prudential standards on state-regulated insurers. Again, the imposition of unnecessary and duplicative federal solvency regulations on insurers serves no useful purpose and threatens to drive up the cost of insurance for consumers.

State Insurer Resolution Authority

The Dodd-Frank Act grants federal regulators the authority to resolve failing financial companies. However, insurance companies are already subject to existing state solvency

guaranty funds that protect consumers. In the last 40 years, our property-casualty guaranty system has paid out roughly $21 billion to consumer/policyholders on behalf of insolvent insurers – a clear indication that the current state-based system works to protect insurance consumers. While Dodd-Frank properly reserved to the states the authority to resolve failing insurance companies, the Act needs tightening in several ways to ensure that federal regulators do not have the power to intrude improperly on state authority to resolve insurers.

Insurer Assessments. Dodd-Frank also unfairly asks certain insurers to help defray the costs of federal resolutions of other non-insurer financial firms. As noted above, insurers are already required to pay into state insurance resolution funds to help ensure that policyholders of other failed insurers are honored. The imposition of federal resolution assessments on insurers imposes the potential for double assessments on insurers. Because insurers already pay at the state level 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. Doing so creates inequity, as the Act does not require non-insurance entities to pay for insurer resolution costs. Dodd-Frank 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 prevent the FDIC (a federal bank regulator) from imposing a double resolution assessment on state-regulated insurers. The most unfair impact of double assessments would be on small businesses and individual insurance consumers, who would ultimately bear a high portion of the cost. PCI therefore recommends that the Subcommittee consider legislation that would expressly bar the FDIC from imposing assessments on insurers to pay for the resolution of systemically important firms.

Liens on Insurer Assets. Section 204(d)(4) of the Act permits the Federal Deposit Insurance Corporation (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. This creates the potential for the FDIC to take a lien against insurance company assets to help shore up an affiliated non-insurance company. State insurance regulators comprehensively regulate insurer investments to ensure that adequate capital and surplus is 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 even consulting with state insurance regulators, the Act creates the potential for federal regulators to imperil the ability of insurers to honor claims to policyholders, giving priority to claimants who are not policyholders. PCI recommends that the Subcommittee consider remedial legislation to eliminate this threat to insurance consumers.

Volcker Rule

While the DFA's Volcker rule was intended to restrict the ability of banks to engage in proprietary trading, the statutory language applies to all affiliates within a holding company that includes a depository institution. Absent an insurer exemption, this would preclude insurers affiliated with a depository institution within a holding company from carrying out common investment activities.

Congress recognized that insurer investment activities are already heavily regulated and closely supervised by state insurance regulators, whose job it is to ensure that insurers licensed in their states remain solvent and able to pay claims. These strict state insurance investment laws prohibit insurers from making investments that are detrimental to the interests of policyholders. Congress therefore included in the Volcker Rule an exemption for investments by a regulated insurance company or its affiliates for the general account of the insurance company. The exemption is predicated on a requirement that the investments be in compliance with all applicable state insurance investment laws and regulations, and that the federal banking agencies do not jointly determine that the existing state investment laws and regulations are insufficient to protect the safety and soundness of the banking entity or the nation's financial stability. The exemption does not extend, however, to an insurer's non-insurance affiliates.

The Federal Reserve Board and other agencies charged with promulgating the Volcker Rule have crafted a proposed rule that, *with one exception*, appropriately allows insurers to continue their state regulated investment activities. The exception relates to insurer investments in hedge funds and private equity funds ("covered funds" under DFA). While the DFA statutory language in no way limits the insurance carve-out for covered funds investment, the proposed Volcker rule fails to include the insurance exemption in the covered funds restrictions, creating a

significant ambiguity between the statute and proposed rule and the possibility that insurers could be prohibited from making such investments or be subject to federal capital requirements if they do.

Federal Insurance Office (FIO)

Dodd-Frank created, for the first time, a federal office in the U.S. government charged with the responsibility of monitoring the insurance industry and making recommendations to Congress. PCI supported the creation of the Federal Insurance Office (FIO) with an appropriately focused mission. FIO has a highly qualified director in Michael McRaith, who is assembling an experienced and knowledgeable staff. PCI has worked cooperatively and constructively with FIO as it seeks to discharge its duties, but we do urge the Subcommittee to monitor FIO's activities closely over time to guard against tendencies toward "mission creep" that might tempt future leaders of that office to stray from FIO's statutorily assigned tasks.

International Focus. One of FIO's most important statutory roles is in coordinating the federal government's policy on international insurance matters, including U.S. representation in the International Association of Insurance Supervisors (IAIS) and other international fora. The insurance marketplace, and its regulation, are becoming increasingly global. FIO's new international role, if exercised in careful coordination with state regulators and insurers, can now help the U.S. speak with a single strong voice in international fora. We see this as the area in which the FIO can make its greatest impact and contribution.

One of the greatest challenges to the insurance marketplace is the unprecedented proliferation of international discussions on insurance regulatory standards, including those engaged in by the G-20, the Financial Stability Board (FSB) and the IAIS, as well as increasingly important trade negotiations with individual countries and international organizations such as the Organization for Economic Cooperation and Development (OECD). There is an increasingly strong movement to standardize insurance supervision throughout the globe. PCI supports consideration of international prudential standards where convergence helps consumers and strengthens the competitiveness of the marketplace. However, the insurance international

standard-setting this process is currently being driven largely by non-U.S. regulatory staff that in some cases want to export their regulatory inefficiencies, forcing the U.S. to converge toward their systems and standards without proper regard for the needs and culture of the U.S. market. FIO's new strong voice in these discussions can now help to ensure that the strengths and differences of the U.S. insurance market will be recognized.

Subpoena Power. PCI is also concerned about the Dodd-Frank Act's grant of subpoena power to the FIO. Dodd-Frank gave FIO exceedingly broad subpoena powers that are inappropriate for a non-regulator. In fact, the powers are much broader than those most other Treasury agencies have. Treasury's usual subpoena powers generally fall into three categories: (1) formal administrative proceedings; (2) criminal or civil investigations and enforcement of laws/regulations; and (3) Inspector General investigative powers.[1] The subpoena power granted in 31 U.S.C. Section 313(e)(6) does not fit into any of these categories, thereby establishing a troubling precedent for government information demands.

Although Dodd-Frank Section 313(e)(4) instructs FIO to coordinate with state and other federal agencies before seeking data from insurers, FIO's subpoena power is not otherwise constrained beyond a requirement that FIO must believe that the information it wants is relevant to its mission. No suspicion of criminal or civil violations of a law or regulation is required. No formal administrative proceeding must be initiated. Because FIO is not a regulator, FIO cannot issue a subpoena in furtherance of a regulatory function, such as a financial examination. The state insurance departments, however, are regulators and already have the legal power to obtain information and data from insurers, either by subpoena or otherwise (*See, e.g.*, NAIC Model Law on Examinations, NAIC Insurer Receivership Model Act; NAIC Unfair Trade Practices Model Act). In addition to subpoena power, state regulators have an even bigger stick to get information – the ability to withhold or revoke licenses or to take other disciplinary action against uncooperative insurers.

PCI's concern is that future FIO directors may not always coordinate with the state insurance regulators and could subpoena information that insurers are providing or have already

[1] U. S. Department of Justice, Office of Legal Policy, *Report to Congress on the Use of Administrative Subpoena Authorities by Executive Branch Agencies and Entities*, (2001).

provided to the state insurance regulators and significantly increase our administrative expenses and burdens. In addition, because the Office of Financial Research (OFR) is required to obtain any information it needs on insurers from FIO, PCI is concerned that a lack of coordination could further exacerbate marketplace administrative expenses and burdens. The best process for getting federal agencies information about the insurance industry and specific companies is for FIO to use the power already given to it by Dodd-Frank to request it from the states (and then share it with OFR) and take advantage of the inherent regulatory authority the states have to compel production. Taking this approach would in no way inhibit FIO's ability to fulfill its functions. To help ensure that this more constructive approach is utilized, and to avoid unnecessary and costly subpoenas on insurers, PCI urges the Subcommittee to consider legislation that would remove FIO's subpoena power.

Confidentiality. Dodd-Frank gave FIO the authority to monitor all aspects of the insurance industry, including the ability to gather information about the industry consistent with FIO's statutory functions. However, the Act, did not adequately acknowledge the role that state regulators play in regulating individual companies and the industry.

The Act included a very well-intentioned provision meant to ensure that the confidentiality of non-publicly available data submitted to the FIO would be protected. PCI is concerned, however, that a provision protecting privileged information *submitted to* the FIO might not be tight enough to ensure that this information will continue to enjoy privilege if FIO were to share it with other federal agencies, such as the OFR or the FSOC, or with state insurance regulators. In addition, there is no guarantee that privileged information submitted to state regulators would retain that privilege when state regulators share it with FIO. PCI recommends that the Subcommittee consider legislation that would tighten these confidentiality protections and clarify that all privileged information flowing to or from FIO regarding insurers will not lose its privilege merely because it is being legitimately shared among various agencies and regulators. This is similar in concept to provisions of the National Association of Insurance Commissioners' (NAIC) Insurance Holding Company Model Act, which provides that privileged information shared by state insurance regulators with other state, federal or international regulators does not lose confidentiality protections.

Source of Strength Rule

DFA also requires insurers to serve as a source of strength for affiliated banks. This runs counter to the general requirement state regulators observe that insurers existing in a holding company should be "walled off" from non-insurer affiliates to ensure that regulatory capital required to support the underwriting obligations of the insurer cannot be compromised. It is unfortunate that the Congress failed to address this concern adequately in DFA, and we urge the Committee to monitor this issue closely and to consider remedial legislation to prevent the exercise of DFA powers that could threaten insurers and their consumers.

Lender Placed Insurance

DFA also created the new Bureau of Consumer Financial Protection (CFPB), which poses some potential threats to insurers. Although the business of insurance is generally outside of the CFPB's jurisdiction, agency activities have appeared increasingly hostile to lender-placed insurance, which is coverage purchased by lenders to cover (usually temporarily) properties for which owners have failed to maintain property insurance required by their mortgages. Lender-placed coverage is a critical element of commercial and residential lending and thus to the real estate market. Unwarranted regulatory and legal hostility towards it can threaten to undermine the much-needed recovery of the U.S. real estate markets. DFA includes new amendments to the Real Estate Settlement Procedures Act (RESPA) providing strict new procedures under which lender-placed coverage can be utilized, but expressly states that the CFPB has no authority to regulate lender-placed insurance rates.

PCI is concerned that some state and federal regulators have taken an overly hostile view towards lender-placed insurance. Given that product's importance to healthy credit markets and to the recovery of the housing market, regulators must be careful not to delay that recovery by taking imprudent actions on lender-placed insurance issues. PCI member companies are working cooperatively and constructively with regulators to address consumer concerns in that market, but regulators must keep a level head to avoid doing further damage to the nation's fragile

housing market. PCI recommends that the Subcommittee monitor developments in this area carefully to ensure that this critical insurance market is not unduly hindered.

Nonadmitted and Reinsurance Reform Act

DFA included bi-partisan and industry supported provisions for the modernization of the regulatory system of the nonadmitted insurance market, commonly referred to as surplus lines. Through the NRRA, a national framework was established to bring about greater consistency and efficiency to the taxation and regulation of surplus lines insurance that would bring benefit to insurance consumers, insurers, and brokers alike. However, to fully achieve the benefits of the NRRA, individual state legislatures and regulators must consistently adopt and implement the letter and spirit of the law. PCI recommends that the Subcommittee monitor developments in this matter to ensure that this critical insurance market fully realizes the intended changes, including consistent implementation of uniform standards for surplus lines eligibility.

* * *

Again, PCI appreciates the opportunity to share our views and we stand ready to assist the Subcommittee as it fulfills its responsibility to address issues related to implementation of the Dodd-Frank Act and its impact on insurers.

INSURANCE OVERSIGHT: POLICY IMPLICATIONS FOR U.S. CONSUMERS, BUSINESSES, AND JOBS, PART 2

HEARING

BEFORE THE

SUBCOMMITTEE ON INSURANCE, HOUSING AND COMMUNITY OPPORTUNITY

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED TWELFTH CONGRESS

FIRST SESSION

OCTOBER 25, 2011

Printed for the use of the Committee on Financial Services

Serial No. 112–77

U.S. GOVERNMENT PRINTING OFFICE

72-618 PDF WASHINGTON : 2012

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

the professionals who serve in departments around the country. In every State in this country, consumers are well served by very capable, hardworking, ethical regulatory professionals. The traditional PNC life insurers did fare well going through the crisis.

Mr. STIVERS. And as a follow-up to that, was it the regulated insurance products of AIG or the unregulated derivatives—and you have kind of already answered this—that helped lead to the downfall of the AIG and the collapse of the financial markets?

Mr. MCRAITH. The autopsy has, frankly, shown that it was not the insurers that caused problems for AIG as a holding company.

Mr. STIVERS. Great. Thank you.

The FIO is charged with doing a study of whether any additional—I won't use the word regulation—coordination is needed in the Federal office for insurance markets. What are you doing to make sure that the bias of your agency—basically, you are getting to answer the question, do I need to do more? What are you doing to make sure that there is not a bias toward additional Federal involvement in insurance?

Mr. MCRAITH. Congressman, let me be clear about AIG. We should not use that as an example, and we should not use the recent crisis as a reason not to examine or explore whether we can better regulate the insurance sector. Are there inefficiencies? Are there inadequacies in the system? For purposes of the modernization in improvement report that we are required to publish, we will study all challenges and problems within—or potential gaps within the existing insurance system.

Mr. STIVERS. And that is great. Are you doing anything to ensure that the bias doesn't come back that automatically says, I am the one deciding and I think I should do more? That is my question.

Mr. MCRAITH. I think you just asked me if I still agreed with my statement from 2008. I think I gave you a direct answer on that.

Mr. STIVERS. Yes.

Mr. MCRAITH. And I would say that the bias is framed by the statute. The statute requires us to study these issues, gave us considerations—six considerations, six factors. We will study those factors and considerations, we will consider comments we receive, and we will report back as required by the statute.

Mr. STIVERS. That is great. That is a good answer.

On subpoena authority, there seems to be a principle of regulatory law that usually it is only a regulator that has enforcement authority, that has subpoena power, but you have been given subpoena power. Do you expect to use that subpoena power or do you expect to work through State regulators? I think you have already answered this question, but I would just like to hear you kind of answer it directly.

Mr. MCRAITH. The subpoena power as framed by the statute would be used only in the event we cannot, for whatever reason, receive data from a State regulator, a Federal regulator, the Office of Financial Research, or we ask a business of insurance participant to produce information which they then refuse to produce. We then have to write findings in support of our subpoena and then issue the subpoena.

So the possibility of actually issuing a subpoena to collect information is extremely unlikely and would only be necessary, in my

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[DISCUSSION DRAFT]

112TH CONGRESS
2D SESSION

H. R. ______

To exclude insurance companies from the Federal Depository Insurance Corporation's "orderly liquidation authority".

IN THE HOUSE OF REPRESENTATIVES

Mr. POSEY introduced the following bill; which was referred to the Committee on ______________________

A BILL

To exclude insurance companies from the Federal Depository Insurance Corporation's "orderly liquidation authority".

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 **SECTION 1. SHORT TITLE.**
4 This Act may be cited as the "____________ Act
5 of 2012".
6 **SEC. 2. LIQUIDATION AUTHORITY.**
7 (a) DEFINITION OF FINANCIAL COMPANY.—Clause
8 (iii) of section 201(a)(11)(B) of the Dodd-Frank Wall
9 Street Reform and Consumer Protection Act (12 U.S.C.

1 5381(a)(11)(B)(iii)) is amended by inserting "an insur-
2 ance company or" after "other than".
3 (b) TREATMENT OF INSURANCE COMPANIES AND
4 SUBSIDIARIES.—Subsection (e) of section 203 of the
5 Dodd-Frank Wall Street Reform and Consumer Protec-
6 tion Act (12 U.S.C. 5383(e)) is amended—
7 (1) in paragraph (1)—
8 (A) by striking "if an insurance company
9 is a covered financial company or a subsidiary
10 or affiliate of a covered financial company,";
11 and
12 (B) by striking "such insurance" and in-
13 serting "an insurance"; and
14 (2) by striking paragraph (3).
15 (c) ASSESSMENTS.—Paragraph (1) of section 210(o)
16 of the Dodd-Frank Wall Street Reform and Consumer
17 Protection Act (12 U.S.C. 5390(o)(1)) is amended by in-
18 serting ", excluding an insurance company subject to as-
19 sessment pursuant to applicable State law to cover (or re-
20 imburse payments made to cover) the costs of rehabilita-
21 tion, liquidation, or other State insolvency proceeding with
22 respect to 1 or more insurance companies," after
23 "$50,000,000,000" each place such term appears.