Testimony
Property Casualty Insurers Association of America (PCI)

U.S. Insurance Sector: International Competitiveness and Jobs
Subcommittee on Capital Markets, Insurance and Government-Sponsored Enterprises
Committee on Financial Services
United States House of Representatives
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The Property Casualty Insurers Association of America (PCI) appreciates the opportunity to submit testimony to the Subcommittee concerning international competitiveness in the insurance sector. PCI is the leading property-casualty trade association. 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 $180 billion in annual premium, 38.3 percent of the nation's property casualty insurance. Member companies write 44.3 percent of the U.S. automobile insurance market, 31.6 percent of the homeowners market, 36.3 percent of the commercial property and liability market, and 42.6 percent of the private workers compensation market.

For most of the history of the U.S. insurance industry, regulatory issues have been focused almost solely on the state level where insurance is regulated, with only limited focus in Washington, D.C. on discrete issues such as flood and terrorism insurance. In recent years, however, insurance standards affecting almost every aspect of regulation are being established by financial supervisors outside of the U.S. in various international fora.

This internationalization of insurance regulation has significantly escalated since the onset of the 2008 financial crisis. In 2009, the G20 finance ministers and bank regulators committed to establishing "internationally agreed high standards that a global system requires" and to create a new Financial Stability Board (FSB) of primarily finance ministers and bank regulators to "reshape our regulatory systems". The U.S. Department of Treasury the same year advocated the need to "coordinate international financial policy through the G-20, the Financial Stability Board, and the Basel Committee on Banking Supervision". FSB members, including Treasury and the Federal Reserve Board, have committed their countries to implement global standards, including FSB standards on insurance and the insurance core principles (ICPs) developed by the International Association of Insurers Supervisors (IAIS).

While insurance has not been a primary focus of the G-20 or FSB, demands for additional insurance regulation are frequently included in the barrage of FSB international reform directives because insurance is a part of the financial sector, and especially because insurers often exist within financial groups that engage in a range of financial services. Neither Congress nor the states have authorized any of these international standard setting efforts, nor does the FSB include any insurance-specific members other than the IAIS. Yet the breadth of demands to impose often bank-centric or European-centric standards has been rapidly expanding, frequently with no showing of existing U.S. regulatory shortcomings that would justify such new standards to

protect consumers in the U.S. marketplace. Insurers are not banks, and property-casualty insurance in particular is influenced by local rules and structured in a uniquely different manner from banking and investment conglomerates whose activities might be more conducive to global regulation or standards.

For more than a hundred years, the states have successfully regulated the business of insurance. State solvency regulation has been particularly successful in the last two decades, achieving a high level of relative uniformity with few failures – particularly during the recent financial crisis. While catastrophic failures occurred in other parts of the financial services sector in the U.S. and worldwide, there were no major failures in the U.S. insurance sector, with traditional home, auto, and business insurance activities particularly strong and solvent. While some of the financial firms that faced challenges in 2008 did have insurance subsidiaries, those subsidiaries remained well-capitalized and strong while other more risky non-insurance activities occurring in other subsidiaries created the difficulties. Thus, the state insurance regulatory system performed well and insurance activities were not a cause of the financial crisis.

PCI and the states have previously recognized that there are limited areas where state insurance law can be improved in discussions with international standard setters. In particular, PCI is actively supporting the ongoing efforts by the states to strengthen group supervision and holding company oversight through adoption of updates to the National Association of Insurance Commissioners' (NAIC) Model Holding Company Act and development of an Own Risk and Solvency Assessment (ORSA) model law. PCI is also working with the NAIC on its Solvency Modernization Initiative (SMI). However, U.S. consumers and the marketplace would not benefit from a complete overhaul just for the sake of implementing international standards that are not designed for the U.S. marketplace. For example, both the Federal Insurance Office (FIO) and the NAIC have recently suggested that U.S. consumers would not benefit from having the United States replace the well-tested state regulatory system with the Solvency II standards that are required by the European Union for equivalence, particularly since Solvency II is still an untested system that could significantly impact U.S. competitiveness. We urge the Congress to monitor these developments closely and to discourage inappropriate international pressure on the U.S. regulatory system that is not in the best interests of U.S. consumers.

The following will summarize a number of current key international insurance regulatory efforts. At this time, we believe that these issues are most appropriately addressed by the industry, state insurance regulators and their international counterparts, and there is no current need for active Federal intervention beyond general monitoring of developments and countering any inappropriate pressure on state insurance regulators from international banking-dominated entities. The one exception is that the FIO has been given statutory authority to "coordinate Federal efforts and develop Federal policy on prudential aspects of international insurance matters." This is the area in which the FIO can make its most constructive contribution and PCI believes that Congress should urge the FIO to make international insurance leadership its primary focus. Indeed, the FIO has already moved into a positive international leadership role for insurance.

New Global Supervision - Background

Prompted by the 2008 financial crisis, the G20 converted the Financial Services Forum, a former think-tank organization made up primarily of banking regulators and focused on bank regulation into what is now known as the Financial Stability Board (FSB). The FSB is charged with providing an early warning of financial risks, reshaping regulatory systems, and extending regulation and oversight to all systemically important financial institutions and markets. The FSB's new membership was expanded to include numerous additional banking regulators, finance ministers, and standard-setting bodies, including the International Association of Insurance Supervisors (IAIS).

The IAIS was created in 1994 to "promote effective and globally consistent supervision of the insurance industry." It includes insurance regulators from 190 jurisdictions (including the FIO) constituting 98 percent of the world's insurance premiums. IAIS members, including U.S. state insurance regulators, are committed to IAIS standards, including the 26 IAIS Insurance Core Principles (ICPs) on issues such as corporate governance, accounting standards, holding company risk oversight, and capital standards. U.S. commitments to the ICPs flow from both federal banking (and securities) regulators representing our country globally and from state insurance regulators through their IAIS membership. Commitment does not mean the international standards are automatically adopted in the U.S. Nevertheless, federal and state regulators are vested in the development of the international standards and may often feel honor bound to adopt them domestically. Moreover, U.S. regulators know that they will be subject to international and public review and critique, including a formal critique by the International Monetary Fund (IMF) and the World Bank every five years in those organizations' Financial Sector Assessment Program (FSAP). They are also aware that the FSB is developing a "toolbox of measures to promote adherence." These considerations automatically make international standards part of the domestic agenda and they often become a default position, likely to be adopted except where regulators determine that the standards are inappropriate for our local market**.** PCI recognizes international concerns about group risk supervision, which the states are rapidly addressing, but opposes efforts to impose uncompetitive international standards wholesale, particularly where no gap or considered need has been specifically identified.

International Systemic Importance

The IAIS has announced that the FSB and "national authorities" will not determine until the first quarter of 2013 which, if any, large global insurers are systemically important (G-SIIs, for "global systemically important insurers"). U.S. insurers had strongly urged the IAIS and the FSB not to rush their process to meet any predetermined timelines and, in particular, to take care not to enact global standards that would deviate from U.S. systemic risk designation procedures and standards for nonbanks that have only just recently been finalized. PCI has demonstrated with extensive quantitative and qualitative analysis in both domestic and international fora that companies engaged primarily in traditional property casualty insurance are not systemically important, although a few insurance holding companies may be engaged in systemically important activities through non-insurance affiliates.

IAIS ComFrame Developments

In July 2010, the IAIS announced the development of the Common Framework for the Supervision of Internationally Active Insurance Groups (or ComFrame). ComFrame is intended to: (1) develop methods of operating group-wide supervision of Internationally Active Insurance Groups (IAIGs) in order to make group-wide supervision more effective and more reflective of actual business practices; (2) establish a comprehensive framework for supervisors to address group-wide activities and risks; and (3) foster global convergence of regulatory and supervisory measures and approaches. ComFrame has been one of the most divisive insurance standard development efforts, with many of ComFrame's proponents pushing for global standards and regulation of IAIGs, including common capital standards. ComFrame discussions have also been divided over whether group regulation should be merely coordinated through an international supervisory college (which are rapidly being formed for not-yet-designated IAIGs) or formalized with additional layers of international regulation.

U.S. insurers continue to resist attempts to impose heightened capital, reporting and other standards for IAIGs, and in general are supporting the NAIC's efforts to focus ComFrame on increased international cooperation and development of a coordinated system with some common language to help regulators assess group capital. PCI recognizes that it may be appropriate to improve regulatory coordination of supervision of international insurers. However, insurers should not be penalized merely because they are geographically diversified, particularly where they may be smaller or less complex than their domestic competitors. While international regulation of U.S. insurers doing business in multiple countries may create a level playing field relative to their most hamstrung foreign competitors, it hurts U.S. competitiveness domestically and internationally, creating a local unlevel playing field and impairing U.S. insurance jobs.

Accounting Convergence

One of the first FSB-announced priorities is global adoption of international accounting standards. The International Accounting Standards Board (IASB) and the (U.S.) Financial Accounting Standards Board (FASB) are nearing conclusion of their negotiations over their proposed international accounting standards for insurers. Of particular note are ongoing pressures from the IASB to change U.S. accounting for insurance contracts, requiring additional risk margins and discounting for insurance reserves, even for non-life reserves where it would add additional uncertainty, reducing the value of insurance information for investors and imposing additional costs for insurers. The Boards are also continuing to work through the remaining issues in other key joint convergence projects including accounting for leases and how to account for various financial instruments, both of which could have an impact on insurers' financial statements. The SEC is expected to announce its decision on whether to adopt in whole or in part International Financial Reporting Standards (IFRS) for publicly traded companies in the United States later this year. Subsequent to a determination by the SEC, the NAIC and state insurance regulators have indicated they will make a determination regarding the extent of convergence of the SEC's authorized accounting standards into state regulatory Statutory Accounting Principles (SAP). PCI members analyzing the cost of full accounting convergence have suggested that the initial implementation costs could exceed those of Sarbanes-Oxley with questionable, if any, benefits for consumers or investors.

Solvency II / U.S.-EU Equivalence

The European Union is working towards modernization of Europe's prudential insurance regulation under a new system called Solvency II. While Solvency II has not yet been finalized or implemented, the EU is requiring foreign jurisdictions to have equivalent standards to their planned system in order to avoid discriminatory treatment. Solvency II includes three pillars: (1) quantitative financial requirements such as capital; (2) governance, risk management and supervision; and (3) disclosure; with a particular focus on increasing insurance capital requirements and risk management. The Solvency II Directive provides for an assessment by the European supervisors of the "equivalence" of non-EU jurisdictions, to determine whether they provide a similar level of policyholder/beneficiary protection as the one provided under the Solvency II Directive. Insurers from countries without equivalence will face discriminatory regulatory standards.

While the U.S. will not be among the countries initially deemed equivalent, the EU's Solvency II update (expected this fall) will include a special process during which certain jurisdictions, including presumably the United States, that agree to work toward equivalence will be treated as equivalent during a five-year transitional period. FIO and the NAIC have insisted that this process focus on "mutual recognition" more than "equivalence." They point to the success of the time-tested US solvency regulatory system and question whether it should be judged against a theoretical European system designed for a significantly different market that will not even be implemented fully until 2014.

The Transatlantic Dialogue and the ongoing discussions by the FIO, NAIC, European Commission (EC) and European Insurance and Occupational Pensions Authority (EIOPA) regarding US and EU insurance regulation appear to be engendering greater understanding of each other's regulatory systems. A joint "steering committee" has been created to organize reviews of several issues of difference, including group supervision, minimum capital standards, reinsurance collateral, and confidentiality and data protection. Formal semi-annual meetings are being held, one each in the U.S. and in Europe. PCI urges Congress to monitor these developments closely and to discourage the imposition on U.S. insurers of excessive and unnecessary EU standards. The U.S. state insurance regulatory system has a strong solvency record that served the U.S. market well during the 2008 financial crisis and its aftermath, with additional improvements in group supervision already underway. The EU has a different regulatory system based on different market structures, tort laws, and corporate governance, which may not always be appropriate for the U.S. market and consumers.

Confidentiality

Confidentiality and data security are slowly increasing in significance in international financial dialogues. As insurers are being pushed to report proprietary information to various non-regulators such as the NAIC, and ultimately to non-government entities such as the IAIS, FSB, and G20, control and limits on the scope of sharing of confidential data are weakening. For example, the FSB has demanded access to information that a limited group of U.S. insurers previously provided through their state regulator solely for review by the IAIS. The FSB is not a regulator or government entity and its request exceeds the scope of the IAIS' promises when the data was

collected. While the various new international players have been developing information-sharing Memoranda of Understanding (MOUs), the protections are still being developed and the legal certainty of these MOUs is still in question. PCI encourages the Congress to monitor developments carefully to ensure that adequate confidentiality protections are in place for U.S. industry and consumers

NAIC Response

The aforementioned international developments and pressures have prompted the NAIC to undertake several initiatives in response:

Model Holding Company Act. The NAIC quickly addressed the need identified during the recent financial crisis for greater oversight of the potentially systemically risky non-insurance activities of insurance holding companies by adopting revisions to its the Model Holding Company Act (MHCA). This Act requires insurance holding companies to report to regulators at least annually on their enterprise risks, including future business plans, information on guarantees from one affiliate to another, and any material activity that could adversely affect the group. The MHCA also requires certain notices of change of control, greater regulation of certain affiliate transactions, increased authority for state insurance regulators to examine an insurers' affiliates' enterprise risk, and authorization to institute or participate in supervisory colleges of regulators of international groups. PCI actively supports state adoption and uniform implementation of the MHCA, recognizing that it successfully addresses the primary insurance regulatory gap identified during the recent financial crisis.

Own Risk and Solvency Assessment (ORSA). State insurance regulators are also trying to enhance supervision of enterprise risk management through development and adoption of a model law on Own Risk and Solvency Assessments ("ORSA"). The ORSA concept, based on Solvency II and the IAIS' enterprise risk management standards, requires insurers to conduct a periodic assessment of their risk management policies, exposure to stressed situations, and adequacy of their capital when all material risks are taken into account, and to report on this process to their regulators at the regulator's request.

The NAIC's Group Solvency Issues Working Group recently released a revised draft ORSA Model Law that was disappointing in that it omitted several key items that are necessary for insurers to comply. The latest draft fails to reference a "lead state" that would coordinate regulatory requests for ORSA-related information after domiciliary regulators have received ORSA reports from their companies, as well as containing inadequate confidentiality protections. PCI is working closely with the NAIC, state regulators, and our industry colleagues to achieve a workable ORSA Model Law that can be adopted uniformly by the states. A proper ORSA requirement could be an important complement to the MHCA in providing state insurance regulators with broad enterprise risk oversight of insurance holding companies, as well as allowing international groups to file one ORSA report worldwide.

Corporate Governance. One of the 26 IAIS's Insurance Core Principles (ICPs) sets forth global standards that countries are supposed to adopt for corporate governance. The NAIC began formal consideration in 2010 of that ICP together with a White Paper for use in U.S. insurance regulation,

asking insurers for comments as to how U.S. insurance regulators may achieve substantial compliance with the IAIS ICPs. PCI and many others strongly objected to application of the IAIS corporate governance principles in the U.S., noting that they are largely based on a European civil code system, for a different type of insurer, with less prominent tort and commercial law than is the case in the U.S. The NAIC subsequently began to conduct a comparison of all current US corporate governance requirements with the NAIC's solvency regulation core principles and the IAIS' ICPs and has since proposed a new set of annual disclosures with regards to the board's corporate governance activities and significantly increased examination guidance. Current discussions with the NAIC are now underscoring that consumers could be better served by reviewing current U.S. regulatory and legal corporate governance requirements to assess any gaps that could harm consumers, rather than trying to achieve similar outcomes to a global standard designed for other countries' systems.

Other Issues

Reinsurance Collateral. U.S. trade negotiators and state insurance regulators have been under pressure for some time from the E.U. and elsewhere to reduce current requirements that non-U.S. reinsurers must post collateral protecting their liabilities to U.S. insurers. Most domestic insurers continue to believe that maintaining collateral protections is an important tool to strengthen their ability to collect on reinsurance claims from non-U.S. reinsurers. Nevertheless, late last year, the NAIC adopted revisions to its model law and regulation on credit for reinsurance under which reductions in collateral would be permitted based on a number of factors, including the non-U.S. reinsurer's financial rating and an assessment of the quality of insurance regulation in the reinsurer's domiciliary jurisdiction. A number of states are now considering legislation to bring their laws more closely in line with the revised models.

Because the final amendments to the NAIC models included some important protections for U.S. ceding insurers, PCI pledged not to oppose state legislation and regulations that are consistent with those models. However, as these new requirements become effective in the states, we are entering a time of testing in which we will be able to observe whether the loss of full collateral will create any collection issues for U.S. ceding insurers that full collateral had previously prevented.

The Federal Insurance Office will be watching these developments and will undoubtedly be considering whether and how to use power granted to FIO, Treasury, and the USTR by the Dodd-Frank Act to negotiate international agreements on reinsurance collateral requirements, which could then preempt state law. Given that new reduced collateral requirements in the U.S. are only just beginning to take effect, we would urge FIO to take the time to allow the new rules to work and to fully assess their impact before considering any aggressive moves to preempt state law in this area. PCI looks forward to working closely with the FIO and the Congress to assist in evaluating the impact of these new rules on the U.S. market.

Access to Markets in China. Like other U.S. industries, the insurance industry is keenly interested in the growing market in China and in China's willingness to open its markets more fully to international financial services firms. PCI is a member of Engage China, a coalition of 12 U.S. financial services trade associations, which testified yesterday at a hearing in the International Monetary Policy and Trade Subcommittee. Engage China is working hard to promote more open

and transparent Chinese financial markets, and while there is much work yet to do, we do want to highlight one recent and very positive development. In February, China announced a strengthened commitment to open up the mandatory third-party auto liability insurance system to foreign-invested insurance companies. China had previously insisted on limiting that market only to domestic Chinese insurers. This served as a significant barrier to other insurers entering the auto market there given that consumers generally purchase various auto coverages as a package from a single insurer and do not buy third-party coverage separately. The announcement followed extensive meetings between Chinese President Hu Jintao and President Obama and most recently, Chinese Vice President Xi Jinping. PCI commends all who were involved on both sides of these discussions, and pledges to work with U.S. government and trade officials and their Chinese counterparts on the development and implementation of this important new policy.

Brazil/Argentina Reinsurance Restrictions. Insurers and reinsurers in the U.S. and abroad are concerned about protectionist measures that have recently been adopted in Brazil and Argentina that place restrictions on risks that ceding insurers in those countries can cede to reinsurers elsewhere. The new restrictions not only deny international reinsurers full access to both markets but also prevent ceding insurers and their consumers in those countries from benefitting from the best rates and coverages available. More importantly, the rules run counter to one of the reinsurance industry's primary objectives, which is to spread risk geographically.

The U.S., the E.U. and Japan have all recently initiated informal discussions with Argentina, which could eventually lead to a formal complaint at the World Trade Organization (WTO). We urge the Congress to monitor developments in this area closely and to work closely with the Administration to keep this issue at the forefront of bilateral or multilateral discussions on financial services trade involving Brazil and Argentina.

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PCI thanks the Subcommittee for this opportunity to offer of perspective on the many international issues now facing the U.S. insurance industry. We will be pleased continue to work with the Subcommittee to provide any further information or assistance that may be needed.