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and Community Opportunity
Committee on Financial Services
United States House of Representatives

Regarding:
"Insurance Oversight: Policy Implications for U.S. Consumers,
Businesses and Jobs"

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Introduction

Chairman Biggert, Ranking Member Gutierrez, and Members of the Subcommittee, thank you for the opportunity to testify today. My name is John Huff, and I am Director of the Department of Insurance, Financial Institutions and Professional Registration for the State of Missouri. I serve as a non-voting member of the Financial Stability Oversight Council (FSOC), and I am also a member of the National Association of Insurance Commissioners (NAIC). I am very pleased to be here with our current president, Iowa Insurance Commissioner Susan Voss.

Today, I will discuss my and the NAIC's views on systemic risk in the insurance sector and highlight the activities of FSOC that could impact that sector. I will also discuss the continued issue of my ability to consult with fellow insurance regulators on confidential matters, an issue of earlier testimony and a problem that has drawn significant Congressional intervention, for which we are grateful. Finally, I will touch upon our international work regarding the criteria to identify any insurers that may be global systemically important financial institutions (GSIFIs).

Systemic Risk and Insurance

Insurance is a unique product. While bank products involve consumer deposits that are subject to withdrawal on demand at any time, insurance policies involve up-front payment in exchange for a legal promise to pay benefits in the event of a future loss. U.S. insurance companies are subject to stringent capital requirements, limits on the nature and extent of investments, and quarterly analysis and periodic examinations. This stringent regulatory oversight enabled the insurance sector to weather the financial crisis better than other sectors.

It is my view and that of the NAIC that traditional insurance products and activities do not typically create systemic risk. However, connections with other financial activities and non-insurance affiliates may expose some insurers to the impact of systemic risk, and certain products may provide a conduit for systemic risk. In those cases and any other situations where companies become troubled, insurance regulators do have the ability to ring fence insurers in order to protect policyholder assets. The longer-term nature of insurance products makes this an effective tool, and enables regulators to wind troubled insurers down in an orderly manner.

FSOC Activities

It has truly been a privilege to serve on FSOC with colleagues dedicated to protecting the stability of our nation's financial system and preventing another financial crisis. While there has been some criticism regarding the pace of the Council's activities—some believe it is moving too slowly, others believe it is moving too quickly—I firmly believe that our goal must not be just for timely completion, but more importantly for the work to be done right.

Much of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) was not aimed at the insurance sector, but there are a number of FSOC activities that will have an impact on insurance companies and regulators. We are watching how FSOC's activity regarding the Volcker Rule could impact the insurance sector. Section 619 of Dodd-Frank prohibits insured banking institutions and their affiliates from engaging in proprietary trading and subjects designated non-bank financial companies conducting such activities to more stringent regulatory standards. FSOC was directed to conduct a study on Volcker Rule implementation, which confirmed the statute's indication that the business of insurance should be accommodated by permitting affected insurers to continue to engage in investment activities that are in compliance with state laws and regulations. It also highlighted the importance of consulting with state insurance regulators throughout the process, to solicit regulator opinions on defining key terms used in the statute, and to involve regulators in the process used to determine whether an insured depository institution or the stability of the United States is threatened by the investment activities of an affiliated insurer even though such activities are in compliance with relevant investment laws.

As for the non-bank designation process, members of the Council have previously testified in other fora that the Council intends to provide additional guidance and seek additional public comment. While I defer to the U.S. Treasury Department on the specifics, FSOC continues to work hard on this guidance with the intention of releasing it for comment in the near future. I encourage all insurance sector participants to weigh in on that guidance.

On Tuesday, FSOC released its first annual report. This report was a significant undertaking by all the members of FSOC and I applaud them and their staffs for all of their hard work. That report underscores that insurance companies generally withstood the financial crisis well and have since strengthened their balance sheets. While, during the financial crisis, insurers felt some stress as asset prices fell and noncore activities such as securities lending resulted in some losses, the insurance sector remained strong and there was little, if any, disruption to their ability to provide insurance services to consumers and businesses. The report also describes several of the regulatory improvements that the insurance regulators have completed since the financial crisis, a number of which are detailed in Commissioner Voss' testimony, including improvements to insurer disclosure requirements regarding derivatives and their securities lending programs, and the changes that were made to more precisely evaluate the credit quality of insurer investments to commercial mortgage-backed securities (CMBS) and residential mortgage-backed securities (RMBS).

The report identified certain areas that my fellow insurance regulators and I need to continue to monitor closely including insurer exposures to CMBS, RMBS, municipal bonds, and specific European investments. The report also notes the difficulties that financial guaranty and mortgage guaranty insurers, a relatively small portion of the industry, continue to face. These problems are associated with the decline in house prices and market activity, the increased volume in residential real estate foreclosures, and the impairment in the RMBS markets. We also need to continue to monitor the higher than usual claims activity that the property and casualty sector continues to experience as a result of the severe weather and flooding in several parts of the United States including my home state of Missouri.

Finally, during earlier testimony before the Financial Services Oversight and Investigations Subcommittee, I expressed my concerns about the adequate representation of insurance interests, and specifically insurance regulators, on FSOC. At that time, Michael McRaith had been appointed to the position of Director of the Federal Insurance Office (FIO), but he had not yet started, and President Obama had not yet nominated Roy Woodall to fill the Council's voting position of someone with insurance expertise. I also spoke of my restriction from consulting with my fellow insurance regulators on matters before FSOC, despite the fact that state regulation of insurance has thrived based on collaboration and information sharing in confidential settings for many years.

It is critically important that the uniqueness of the insurance business model and the strength of the state-based system of insurance regulation be recognized as FSOC monitors systemic risk and determines which non-bank institutions to designate as systemically important financial institutions (SIFIs). It is the joint responsibility of the FIO Director, the voting member with insurance expertise, and the state insurance regulator to be vigilant in this regard.

I am very pleased that Mike McRaith, the former Director of the Illinois Department of Insurance, is now the first Director of the Federal Insurance Office. Mr. McRaith is well-known among NAIC members; in fact, he was serving as our Secretary-Treasurer immediately before his appointment to the federal government. Our officers have had a number of productive conversations with Mr. McRaith and his colleagues since he came to Washington. I consider us very fortunate to have him in this new role.

I am also pleased that Roy Woodall has been nominated by President Obama to be FSOC's first voting member with insurance expertise. Mr. Woodall will bring both regulatory and industry experience to bear on FSOC decisions, and we current state regulators enjoyed working with him in his most recent capacity at the U.S. Treasury Department. We are watching his confirmation proceedings in the Senate with great interest, and I am very hopeful that he will be able to join the Council as soon as possible.

Thus, I can testify today that FSOC is very close to having its full complement of insurance members on board, as required by statute. Regrettably, I must report that the ability of state insurance regulators to provide input regarding FSOC's important work remains extremely limited. I am still unable to communicate with my fellow commissioners on a confidential basis regarding the matters under consideration by FSOC that portend changes to our regulatory process and that could impact insurers and state insurance markets.

I remain hopeful that my fellow state insurance regulators will soon be able to work with the Council; such collaboration could even take place through a smaller group of designated regulators, who represent the needs of different regions and markets in the country. I firmly believe that such consultation will be vitally important in the coming months as FSOC determines the criteria to be used to identify systemically important non-bank firms and evaluates firms for such designations.

The Council must decide how it will handle state insurance regulator involvement after the formal designation of an insurance company as a SIFI. FSOC, in conjunction with the Federal Reserve Board and the Federal Deposit Insurance Corporation (FDIC), will review resolution plans filed by designated companies; under Dodd-Frank, FSOC is meant to assist both entities in this regard. FSOC has the authority to recommend to the Federal Reserve heightened prudential standards to apply to designated firms; that work will be undertaken by the Council's heightened prudential standards committee. In the event that any insurers are designated, the ability of the Council to receive advice and counsel from my fellow insurance regulators who are involved in the day-to-day regulation of such companies will be critical. Adequate communication among regulators is especially important in light of our continuing international work on designations of GSIFIs.

Identification of Insurance GSIFIs

The NAIC is a founding member of the International Association of Insurance Supervisors (IAIS), and is a committed participant in all of the major IAIS committees and subcommittees. The NAIC also serves as Vice-Chair of the IAIS Financial Stability Committee, which is currently in the process of developing a methodology for identifying insurers that may be GSIFIs. As part of that work, the insurance regulatory representatives to the Financial Stability Committee can consult with and seek the advice of fellow insurance regulators. It is critical for these members to access unique expertise in particular subject areas; such knowledge helps ensure that appropriate methodologies are being considered, and gives members the insights of the hands-on regulators with respect to discussions of particular companies. This is a marked contrast to my work on FSOC where I cannot share confidential information with my fellow regulators in order to obtain their fully-informed views on such issues.

The financial crisis has clearly demonstrated that it is not sufficient to focus on a single sector any longer, and we are increasingly being asked to participate in global dialogues with international supervisors and standard setters from across the financial spectrum. The US, represented by the Treasury Department, the Federal Reserve Board of Governors, and the Securities and Exchange Commission, is a member of the Financial Stability Board (FSB), which is engaging directly with the IAIS on critical issues including GSIFI identification. Our involvement in this process is critical since the FSB is a bank-centric organization; through the IAIS, we continue to stress that the insurance business model needs to be distinguished from the banking business model when applying new regulatory requirements. Additionally, the Treasury Department coordinates input from the various functional regulators or their representatives on FSB projects and priorities, and we have urged the US FSB representatives to reinforce our input and concerns.

The FSB has taken on an increasingly active role in attempting to coordinate regulatory developments around the globe. I would encourage federal regulators and legislators alike to be mindful of both the scope and speed of the board's activity, as this institution should be restrained from acquiring supranational regulatory authorities. Appropriate deference should be provided to the regulatory authorities of member nations.

Conclusion

Throughout the debate over and the implementation of Dodd-Frank, my fellow regulators and I have fought to deliver the message that "one size does not fit all." Both the nature and regulation of insurance products are fundamentally different from the nature and regulation of banking and securities instruments. We remain hopeful that these differences will be adequately acknowledged and accommodated domestically by FSOC and internationally in bodies such as the IAIS and FSB.

Thank you again for the opportunity to testify today. I would be happy to answer any questions.