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On Behalf of the Property Casualty Insurers Association of America (PCI)

Insurance Oversight and Legislative Proposals
Subcommittee on Insurance, Housing and Community Opportunity
Committee on Financial Services
United States House of Representatives
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Chairman Biggert, Ranking Member Gutierrez, Members of the Subcommittee: Thank you for the invitation to appear before you today. I am Michael Lanza, Executive Vice President and General Counsel of the Selective Insurance Group, Inc. Selective is an insurance holding company with seven property casualty insurance subsidiaries. In 2010, it was ranked by A.M. Best as 49th largest property and casualty group in the country. I am also testifying today on behalf of our national trade association, the Property Casualty Insurers Association of America (PCI). PCI, with more than 1,000 member companies, has the broadest membership of any national insurance trade association. PCI members write over $180 billion in annual premium, which represents approximately 38.3 percent of the nation’s property casualty insurance market.

Selective and PCI strongly support the discussion drafts you are considering to clarify the treatment of insurers under various provisions of the Dodd-Frank Act (DFA). Home, auto, and business insurers, while important to our customers in times of need, did not cause the financial crisis and generally are not systemically important to the financial markets. The property casualty (P/C) industry is stable and healthy. Most importantly, as a whole, the industry did not need federal assistance during the recent financial crisis. There are five key reasons why P/C insurers are not systemically risky:

1. They have low financial leverage;
2. They are not highly interconnected with other financial firms;
3. They are in a highly competitive market with low individual company market penetration;

4. They have low failure rates and, through the state guaranty funds, have their own effective resolution authority; and
5. Most importantly, P/C insurers sell products that cannot result in a "run on the bank."

Let me elaborate further on this last point. Liability, property, and casualty policies do not have extra leveraged cash values or discretionary or other investment components that can be withdrawn, such as products issued by life insurers and banks. There is little likelihood that one failed P/C insurer will cause other financial institutions to fail.

In the financial crisis, one prominent insurer with P/C operations received a bailout. That was AIG. It is important to note, however, that the business practices that led to AIG's issues and bailout had nothing to do with its domestically regulated P/C operations.

For these reasons, we believe that it is important to distinguish between non-risky P/C insurers and other types of financial firms that can pose systemic risk to the national economy. Selective and PCI support the amendments proposed in the discussion drafts because they permit this distinction to be made more clearly. *We do not believe that the proposals – in any way – scale back any powers that Dodd-Frank granted federal agencies to regulate the types of risky activities that gave rise to the financial crisis.* The discussion drafts propose technical amendments that clarify Dodd-Frank's application to insurers and reduce the potential for unintended intrusions on state regulatory authority and other unintended consequences, such as significant administrative expense and burden. We anticipate that the proposals will enjoy bipartisan support, and we look forward to working with the Subcommittee to move these proposals forward.

I would like to comment on four areas that the discussion draft amendments address: Confidentiality; Subpoena Power; State Insurer Resolution Authority and Assessment; and Leverage, Capital, and Accounting Standards.

Confidentiality. Dodd-Frank created the Federal Insurance Office (FIO) and gave it authority to monitor all aspects of the insurance industry, including the ability to gather information about the industry consistent with FIO's statutory functions. In our opinion, 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 nonpublicly available data submitted to the FIO would be protected. We, however, are concerned 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 Office of Financial Research (OFR) or the Financial Stability Oversight Council, 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. The discussion draft 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.

Subpoena Power. Dodd-Frank gave FIO exceedingly broad subpoena powers. 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 new precedent for granting subpoena power.

Although Dodd-Frank Section 313(e)(4) instructs FIO to coordinate with other state and 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

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[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).

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.

Our concern is that FIO may not always coordinate with the state insurance regulators and subpoena information that we are providing or have already provided to the state insurance regulators and significantly increase our administrative expenses and burdens. In addition, because the Office of Financial Research is required to obtain any information it needs on insurers from FIO, we are concerned that a lack of coordination could further exacerbate administrative expenses and burdens. We believe that 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.

For this reason, we strongly support the discussion draft's elimination of the subpoena power granted to FIO andOFR. Dodd-Frank already permits FIO to get this information from the states. By duplicating the existing subpoena power of the states, there is a significant likelihood of redundant, costly, and burdensome data calls on insurers that, ultimately, will be borne by consumers.

State Insurer Resolution Authority and Assessments. The Dodd-Frank Act grants federal regulators the authority to resolve financial companies. Insurance companies are already subject to existing state solvency guaranty funds that protect consumers. In the last 40 years, the U.S. property-casualty guaranty system has paid out roughly $21 billion to consumer/policyholders on behalf of insolvent insurers. 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 on state authority to resolve insurers.

Section 204(d)(4) of the Act permits the 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 consultation with state insurance regulators, the Act creates the potential for federal regulators to imperil the ability of insurers to honor claims to policyholders. We believe that the discussion draft appropriately would bar the FDIC from placing a lien on an insurance company's assets without the written consent of the insurance company's domiciliary state regulator.

We also believe that Dodd-Frank also unfairly asks insurers to help defray the costs of federal resolutions of other non-insurer financial firms. 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 a federal resolution assessment on insurers by the Act imposes the potential for double assessment on insurers. 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 requires 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 absolutely bar the FDIC from imposing a double resolution assessment on insurers. We believe that the discussion draft appropriately proposes prohibiting the FDIC from counting insurance assets, liabilities, or revenues in calculating its assessments on financial firms to pay for resolutions of other financial firms.

Leverage, Capital and Accounting Standards. Dodd Frank gives the Federal Reserve Board the power to impose heightened prudential standards on firms that the FSOC finds to be systemically risky. We are pleased that preliminary proposed FSOC rules governing systemic risk determinations would make it relatively unlikely that companies predominantly engaged in the property casualty insurance business will be so designated. Nevertheless, the FSOC rules may change over time and the statute does not absolutely prohibit designations of property casualty insurers. This means that, in the event a P/C insurer ever is designated, the FSOC would have the power to impose heightened prudential standards on that insurer.

Insurer financial standards are regulated by state insurance regulators, but the Act gives the Federal Reserve Board the power to impose its own standards on insurers without consideration of existing state regulatory standards and requirements. We believe that this is another example of the potential the Act creates for intruding inappropriately on state regulatory authority and for creating conflicts between state and federal regulators. To remedy this, the discussion draft requires the Board, in determining whether heightened prudential standards are to be applied to depository institutions and nonbank financial companies that own insurance companies, to take into account the regulatory and accounting procedures applicable to the capital structure of insurance companies and to give deference to applicable state laws governing risk-based capital for insurance companies. We note, in particular, that the Securities and Exchange Commission (SEC) in Section 10(e) of Rule S-K, already recognizes that statutory accounting standards are appropriate for insurers, and this proposal properly requires the Federal Reserve to recognize this as well.

In conclusion, the proposals put forward in the discussion drafts are technical and clarifying. They, however, provide much-needed refinement to the existing Dodd-Frank statutory language. These changes will (i) ensure that federal and state regulators do not impose conflicting or duplicative requirements on insurers, (ii) protect the confidentiality of privileged information shared by and among federal and state agencies, (iii) simplify the process by which

FIO and OFR will obtain information from insurers, and (iv) ensure that risk-based capital remains the foundation of state insurance regulation. We strongly urge the introduction and passage of these important proposals. We look forward to working with all members of the Subcommittee to move them through Congress.

United States House of Representatives
Committee on Financial Services

"TRUTH IN TESTIMONY" DISCLOSURE FORM

Clause 2(g) of rule XI of the Rules of the House of Representatives and the Rules of the Committee on Financial Services require the disclosure of the following information. A copy of this form should be attached to your written testimony.

1. Name:	2. Organization or organizations you are representing:
Michael H. Lanza	Selective Insurance Group, Inc.

3. Business Address and telephone number:

[redacted]

4. Have you received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?	5. Have any of the organizations you are representing received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?
☐ Yes ☑ No	☐ Yes ☑ No

6. If you answered yes, to either item 4 or 5, please list the source and amount of each grant or contract, and indicate whether the recipient of such grant was you or the organization(s) you are representing. You may list additional grants or contracts on additional sheets.

7. Signature:

Michael H Lanza

Please attach a copy of this form to your written testimony.