THE IMPACT OF DOMESTIC REGULATORY STANDARDS ON THE U.S. INSURANCE MARKET

HEARING

BEFORE THE

SUBCOMMITTEE ON HOUSING AND INSURANCE

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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THE IMPACT OF DOMESTIC REGULATORY STANDARDS ON THE U.S. INSURANCE MARKET

Tuesday, September 29, 2015

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

The subcommittee met, pursuant to notice, at 2:05 p.m., in room 2128, Rayburn House Office Building, Hon. Blaine Luetkemeyer [chairman of the subcommittee] presiding.

Members present: Representatives Luetkemeyer, Royce, Pearce, Posey, Stivers, Ross, Barr, Rothfus; Cleaver, Velazquez, Clay, Green, Moore, Ellison, Beatty, and Kildee.

Chairman LUETKEMEYER. The Subcommittee on Housing and Insurance will come to order.

Without objection, the Chair is authorized to declare a recess of the subcommittee at any time. Votes are scheduled in the 3:30 to 4:00 range, so hopefully we will be able to get through everybody's testimony and questions ASAP. So we are going to try to get going here as quickly as possible.

Today's hearing is entitled, "The Impact of Domestic Regulatory Standards on the U.S. Insurance Market." Before we begin, I would like to thank the witnesses for appearing before the subcommittee today. I look forward to your testimony.

I now recognize myself for 4 minutes to give an opening statement.

Our Nation enjoys the most robust policyholder-centric insurance system in the world. The U.S. industry performed well during the financial crisis, and policyholders enjoy the safety and soundness that comes with our Nation's unique regulatory structure.

Despite its proven track record, the domestic regulatory landscape is being forced into significant changes. Today, we see more intrusion in insurance by not only the Federal Government but also international financial regulators. The Dodd-Frank Act has allowed that to happen through the creation of the Federal Insurance Office (FIO) and the powers granted to the Federal Reserve Board of Governors. The subcommittee has spent a great deal of time focused on international factors affecting our insurance impact.

Thanks to Team USA, we have experienced some victories at the International Association of Insurance Supervisors (IAIS). The timeline for international capital standards has been extended, which came as welcome news to this committee, and conversations seem to be pointing us in the right direction on accounting standards.

However, the approach on the IAIS higher loss absorbency rule, or HLA, has created some alarm throughout the U.S. insurance space and has the potential to damage our domestic system. The proposal unjustly harms products relied on by millions of American consumers, an issue that must be addressed without delay. It is imperative that the United States press the IAIS and the Financial Stability Board to push back on this concept and work toward what should be the mission of Team USA to represent and advocate for the existing insurance regulatory regime.

Today, we turn our attention to the many domestic pressures facing the industry. The designation of insurers as systemically important financial institutions (SIFIs) to the Federal Reserve's rulemaking on insurance capital standards, it is essential that changes made to the regulatory landscape be done appropriately and in response to issues that pose risk to policyholders. That is particularly true of the Fed's domestic capital standard. The standard should be done in close coordination with State insurance regulators and should be tailored to meet the unique model and needs of the United States, not based on international conversations or a desire to appease Federal and foreign regulators.

There is a tremendous need for the Federal Reserve, which as a reminder is subject to congressional legislative action, to get this rulemaking right. It is imperative that the Fed develop a domestic standard first, then export it to the rest of the world. It is my hope that today's discussion will also focus on the designation of insurers as SIFIs. The Administration has told this committee time and time again that the decisions on these designations were not born of international conversations and were made based on the extensive research and actual risk posed to the financial system. Yet insurance experts in this room, from whom we will receive testimony today, dissented and have in subsequent situations outlined their concerns over these designations.

There are numerous other issues that have the potential to negatively impact the competitiveness of U.S. insurers. Despite statutory language that calls for a board to be established by April, we have yet to see any progress on the National Association of Registered Agents and Brokers Reform Act of 2015 (NARAB II). We continue to prop up a flood insurance program that doesn't work, and are now requiring the insurance industry to comply with costly duplicative data requests at both the State and Federal levels. While some progress has been seen internationally, I fear that coordination and cooperation has stalled domestically. It is time that the witnesses appearing today work with Congress, industry, and, most importantly, each other to ensure that our domestic insurance system remains the most robust in the world.

With that, the Chair now recognizes the ranking member of the subcommittee, the gentleman from Missouri, Mr. Cleaver, for 5 minutes for an opening statement.

Mr. CLEAVER. Thank you, Mr. Chairman.

And to the other members of the subcommittee, good afternoon. I would like to begin by first thanking our witnesses for their appearance here today, and I would like to issue a special welcome, of course, to John Huff from the great State of Missouri, which is preparing for an I-70 World Series. I am not saying the other teams are not important. They are just not winners.

What I would like to do is welcome all of you, but obviously, I have a special appreciation for the Missourian. Today's hearing will focus on domestic insurance issues. With the passage of the Dodd-Frank Act, the Federal Insurance Office (FIO) was also created. Among many things, this office monitors all aspects of the insurance industry and identifies any gaps that could contribute to the systemic crisis.

The U.S. insurance industry is, of course, primarily regulated by States. However, the consequences of the 2008 worldwide economic crash revealed the extent to which our U.S. financial regulatory framework had allowed for supervisory gaps to exponentially grow. There was simply no single regulator responsible for understanding and supervising the enterprise as a whole.

Though changes have been made to our insurance system as a whole, much of the State regulatory power remains. The FIO is not a financial regulator. They have been, as authorized by Dodd-Frank, working on a number of issues on the domestic level, many of which are referenced in their annual report on the insurance industry that was released yesterday.

Overall, both the life insurance and property and casualty insurance sectors were profitable in 2014. Life insurance net written premiums totaled $648 billion in 2014, and property and casualty net written premiums reached $503 billion in 2014, which was a record high.

I would like to again thank our witnesses for their participation, and I am eager for this conversation on domestic insurance issues to continue and that we will have a robust dialogue.

Thank you very much, Mr. Chairman.

Chairman LUETKEMEYER. Thank you, Mr. Cleaver.

With that, we will begin the testimony. Today, we welcome Director Michael McRaith from the Federal Insurance Office, U.S. Treasury Department; Mr. Tom Sullivan, Senior Adviser, Department of Banking Supervision and Regulation, Federal Reserve Board of Governors; Mr. John Huff, Director, Missouri Department of Insurance, Financial Institutions, and Professional Registration, and president-elect of the National Association of Insurance Commissioners—obviously, Mr. Cleaver and I have a connection to Mr. Huff, and welcome him, with a special welcome—and the Honorable S. Roy Woodall, Jr., independent member, Financial Stability Oversight Council, U.S. Department of the Treasury.

Gentlemen, thank you for being here this afternoon. We have a very distinguished panel, and I am excited to have you here with us. You will each be recognized for 5 minutes to give an oral presentation of your testimony. And without objection, your written statements will be made a part of the record.

With that, Mr. McRaith, you are recognized for 5 minutes.

STATEMENT OF MICHAEL MCRAITH, DIRECTOR, FEDERAL INSURANCE OFFICE (FIO), U.S. DEPARTMENT OF THE TREASURY

Mr. MCRAITH. Chairman Luetkemeyer, Ranking Member Cleaver, and members of the subcommittee, thank you for inviting me to testify. We released FIO's 2015 annual report on the insurance industry yesterday: 2014 data showed the $8.3 trillion U.S. industry reported capital and surplus levels of approximately $1.15 trillion. Total direct premiums collected in 2014 were a record high of $1.2 trillion, or roughly 7 percent of U.S. GDP. Just in the last 10 years, U.S. premium volume has grown by more than $170 billion.

At FIO, we are working to implement the reauthorized Terrorism Risk Insurance Act (TRIA), including working with stakeholders so that we can collect meaningful data in an efficient way. Industry continues to educate us about what data is available and in what format. We are also prepared to release soon a study on the TRIA certification process. FIO is also moving forward with monitoring the affordability and accessibility of personal auto insurance. We need a standard that makes sense from an insurance perspective, and stakeholder input has provided great insight. FIO also serves as a nonvoting FSOC member participating in the analysis of systemic risk and individual firms. In this work, we work closely with staff from other FSOC member agencies, including those represented on this panel.

Our annual report also cites data showing that while U.S. premium volume increased in 2014, the U.S. share of the global insurance market declined from 27.5 to 26.8 percent. This development reflects both the continued vibrancy of the U.S. market, by far the world's largest, and the increasing global growth opportunities for U.S.-based insurers. The globalization of the insurance market explains the increased focus on global standards, and for this reason, among others, FIO has a statutory role to coordinate and develop Federal policy on prudential aspects of international insurance matters, including representing the United States at the IIS. In this work, we collaborate extensively with our colleagues at the State level and at the Federal Reserve.

Importantly, international standards are not self-executing in the United States. Federal and State authorities will study, test, and analyze the potential value and impact of any international standard prior to implementation. The United States has the most diverse and competitive insurance market in the world, with insurers operating in one part of one State and insurers that are multinational and engaged in a variety of financial services.

With this in mind, we work with our U.S. and international counterparts to build a global consensus that works for the United States. In 2014, the IIS completed structural reform that improved the organization's transparency, and we are pleased to note that in 2015, stakeholders have already had more than 60 hours of public engagement with IIS members, far more than ever before. With open meetings available to all stakeholders, the IIS is better able to fashion fact-based standards. One such standard known as higher loss absorbency, or HLA, will be completed as an initial version this year but subject to meaningful improvement in the coming years.

We also hope to commence negotiations on a covered agreement soon. Before we do, we will notify and consult with this and other committees. We look forward to meaningful engagement with all stakeholders throughout the covered agreement process. Not a trade agreement, a covered agreement is an agreement between the United States and another country involving prudential insurance measures. Our objective will be to provide tangible benefits for the U.S. insurance industry and consumers.

Through our respective roles at home and abroad, U.S. authorities will continue to provide leadership that complements our shared interests in a vibrant, well-regulated market that promotes competition and financial stability and that protects consumers. In all of our work, internationally and domestically, Treasury priorities will remain the best interests of U.S. consumers and insurers, the U.S. economy, and jobs for the American people. Thank you for your attention. I look forward to your questions.

[The prepared statement of Director McRaith can be found on page 46 of the appendix.]

Chairman LUETKEMEYER. Thank you, Director.

Mr. Sullivan, you are recognized for 5 minutes.

STATEMENT OF THOMAS SULLIVAN, ASSOCIATE DIRECTOR, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. SULLIVAN. Thank you, Mr. Chairman, Ranking Member Cleaver, and members of the subcommittee. I appreciate the opportunity to testify on behalf of the Federal Reserve.

As a result of the Dodd-Frank Act, the Federal Reserve is responsible for the consolidated supervision of insurance holding companies that own an insured bank or thrift as well as insurance holding companies designated by the FSOC for Federal Reserve supervision. Insurance holding companies for which the Federal Reserve is the consolidated supervisor hold roughly $3 trillion in total assets, which is roughly one-third of the U.S. industry assets. These insurance holding companies vary greatly in terms of their size, the products they offer, and their geography.

After passage of the Dodd-Frank Act, the Federal Reserve moved quickly to develop a supervisory framework that is appropriate for insurance holding companies that own depository institutions, and we promptly assigned supervisory teams to handle day-to-day supervision of each company. We have also acted promptly to commence supervision of three insurance holding companies designated by the FSOC for Federal Reserve supervision. Our supervisory teams are a combination of experienced Federal Reserve staff as well as newly hired staff with insurance expertise. We currently have approximately 90 full-time equivalent employees devoted to the supervision of insurance firms. Many of our supervisors are individuals with substantial prior experience in State insurance departments or the insurance industry. We plan to continue to add staff as appropriate to both the Board and the Reserve Banks to ensure that we have the proper depth and experience to carry out our mandates.

Our supervisory efforts to date have focused on strengthening firms' internal controls, corporate governance, risk identification, measurement, and risk management. Our principal supervisory objectives are protecting the safety and soundness of the consolidated firms and their subsidiary depository institutions, while mitigating any risks to financial stability.

Last year, Congress enacted the Insurance Capital Standards Clarifications Act, which amended the provision of the Dodd-Frank Act that had required minimal capital standards for banks to be applied to any insurance holding company supervised by the Fed. Using greater adaptability provided by this amendment, the Federal Reserve is now focusing on constructing a domestic regulatory capital framework that is well tailored to the business of insurance. We are exercising great care as we approach this challenging mandate. The Federal Reserve is investing significant time and effort into enhancing our understanding of the insurance industry and the firms we supervise. We are committed to tailoring our framework to the specific business lines, risk profiles, and systemic footprints of the firms we oversee. We have increased our staffing and have been engaging extensively with other insurance supervisors, experts, regulated entities, market participants and others, to solicit feedback on the various potential approaches of the development of an appropriate consolidated groupwide capital regime that would be consistent with Federal requirements.

Our consolidated supervision and capital requirements will supplement existing legal entity supervision with a perspective that considers the risks across the entirety of the firm, including risks that emanate from noninsurance subsidiaries and other entities within a group. Our role as a consolidated supervisor does not seek to lessen the critical importance of supervising individual insurance legal entities by the States. We do not regulate the manner in which insurance is provided by these companies or the types of insurance products they provide. Those important aspects of the actual business of providing insurance are the province of the relevant State insurance supervisors. We conduct our consolidated supervision efforts in a manner that is complementary to and coordinated with other insurance regulators. We do this both informally and formally through mechanisms such as supervisory colleges. We also enter into agreements that allow us to share confidential information with State supervisors.

An example of our collaboration with the States is evaluating a company's own risk solvency assessment, or ORSA. Many States have enacted legislation that requires State-regulated insurers to produce this assessment on a groupwide basis. While we recognized that the ORSA process belongs to the lead State regulator, it is a potentially useful and valuable tool for us as well because it is fashioned on a groupwide basis. It has helped us to understand some of the institution's processes for monitoring, measuring, controlling, and managing risks in a way that avoids unnecessary duplication in our oversight function. We have been meeting with State insurance departments to discuss views on ORSA submissions, and we have appreciated their perspective on these subjects. We will continue our active collaboration with State regulators.

Mr. Chairman, thank you for inviting me here today. I look forward to an active dialogue with committee members.

[The prepared statement of Associate Director Sullivan can be found on page 50 of the appendix.]

Chairman LUETKEMEYER. Thank you, Mr. Sullivan.

Mr. Huff, you are now recognized for 5 minutes.

STATEMENT OF JOHN M. HUFF, DIRECTOR, MISSOURI DEPARTMENT OF INSURANCE, FINANCIAL INSTITUTIONS, AND PROFESSIONAL REGISTRATION, ON BEHALF OF THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS (NAIC)

Mr. HUFF. Good afternoon, Chairman Luetkemeyer and Ranking Member Cleaver. I appreciate the opportunity to testify today. As insurance markets grow more complex, State insurance regulators' tools and priorities also evolve. While here in Washington, much of the focus has been on the uncertainty of the international landscape, the capital standards the Federal Reserve will impose, and the operations of the FSOC, State insurance regulators have been working through the open and transparent NAIC process to make significant improvements to key areas of insurance regulation.

As my written testimony details, in the past few years State insurance regulators have made improvements to our Holding Company Act that enhance our ability to regulate interactions among insurance companies and other entities within a holding company system. We have begun implementing a principles-based reserving system that right-sizes reserves for life insurers and reduces the incentives for company workarounds, and we have enhanced the consistency and transparency of life insurer use of captive reinsurance that has been primarily used to address admittedly excessive reserving requirements for certain lines of life insurance. And we work to protect insurance consumers who have been victims of a data breach.

In addition to these enhancements, State insurance regulators have reduced the collateral amounts of requirements for foreign reinsurance transactions in a measured and transparent manner. Historically, we required foreign reinsurers to hold 100 percent collateral on shore in the United States to protect U.S. consumers. Responding to concerns raised by foreign reinsurers and foreign governments, we are permitting collateral reductions if a reinsurer is in a solid financial health position and is overseen by an effective regulator in its home country.

Today, 32 States have adopted proposed revisions representing more than two-thirds of premiums written in the United States across all lines of business. Five more States are considering similar proposals, which would raise this market share to about 93 percent. This is an excellent example of the States responding quickly to global market developments while preserving our focus on U.S. policyholder protection. Despite extensive State responsiveness, we understand that the Treasury Department and the USTR are preparing to start negotiations on a covered agreement with the EU to address further reduction of reinsurance collateral and resolve uncertainty arising from Solvency II. This Federal action could unnecessarily preempt State laws and our progress on reinsurance reforms. We have long contended that although our regulatory system is structured differently than Europe's, it results in similar outcomes and should not be a basis for imposing duplicative regulation on U.S. insurers operating abroad. We question whether a covered agreement or any formal action by the Federal Government is necessary to resolve equivalence as it is clear that recognition can be achieved through other mechanisms.

Before the Federal Government begins negotiating directly with a foreign government on an agreement that could preempt our State insurance laws, we do expect a clear and compelling case to be made for such drastic action. No such case has been made. And should Treasury and the USTR nevertheless move forward, State regulators should be at the table, directly involved in any discussions or negotiations to ensure our State regulatory system is not compromised.

In 2010, I was selected to serve on the FSOC, and I served for two consecutive terms until September of last year. I continue to believe that the FSOC can be a robust vehicle for monitoring risks facing our financial system. However, FSOC has now voted twice to designate insurance companies over the objections of members who know the insurance industry best. Neither the designated companies nor the primary regulators have been given the insights necessary to de-risk these firms. This is unacceptable and contributes to rather than reduces risk to the financial system.

If FSOC is unable or unwilling to change its process to develop an exit ramp for designated firms, we strongly urge Congress to do so. SIFI designations are not merely academic exercises. They will have real consequences for firms subject to the Federal Reserve's new capital standards. NAIC supported legislation last year granting our colleagues at the Fed flexibility to apply capital rules consistent with the insurance business model and our legal entity regulation. For our part, State insurance regulators also support the need to assess the adequacy of an insurance group's capital position as part of coordinated solvency oversight, and we are developing our own group capital calculation.

In conclusion, State insurance regulators continue our efforts to improve regulation in the best interests of U.S. insurance consumers. State regulation has a strong 145-year track record of evolving to meet the challenges posed by dynamic markets, and we continue to believe that well-regulated markets make for well-protected policyholders. Thank you, and I look forward to your questions.

[The prepared statement of Mr. Huff can be found on page 34 of the appendix.]

Chairman LUETKEMEYER. Thank you, Mr. Huff, for your testimony.

And Mr. Woodall, you are recognized for 5 minutes.

STATEMENT OF THE HONORABLE S. ROY WOODALL, JR., INDEPENDENT MEMBER, FINANCIAL STABILITY OVERSIGHT COUNCIL (FSOC)

Mr. WOODALL. Thank you, Mr. Chairman, Mr. Ranking Member, and members of the subcommittee for inviting me to appear before you today.

As you know, I serve on the Financial Stability Oversight Council as the voting member with insight as to the insurance sector of our economy. The other voting members are Federal banking regulators, Federal market and housing regulators, and the Treasury Secretary.

The work of the Council affects many aspects of the financial system, but most prominently with respect to our domestic insurance market has been the Council's work in designating nonbank financial companies as systemically important financial institutions or SIFIs. It has been 7 years now since the financial crisis, 5 years since Dodd-Frank was passed, and to date the Council has designated only four SIFIs, three of which are insurance companies: AIG; Prudential; and MetLife.

Upon designation as SIFIs, the insurance companies become subject to Federal supervision and regulation by the Federal Reserve Board of Governors. And as Tom Sullivan mentioned, this is regulation in addition to that of their primary regulators, our State insurance commissioners. Thus, the Council SIFI designations have impacted the regulatory framework of our domestic insurance market more than any other sector of the economy. But it was not the intent of Dodd-Frank that SIFIs be forever regulated by the Fed. Under Dodd-Frank, the Council has to reevaluate the SIFIs each year and then either confirm that they are still SIFIs or de-designate them. Dodd-Frank envisioned that over time the Council and regulators would supervise the SIFIs to eventually eliminate whatever systemic risks they posed to the U.S. system.

As I explained in my written testimony, I was critical of the way in which the insurer SIFIs were designated. Dodd-Frank provides two tests for SIFI designation. Under one of the tests, the Council can presume that a company is under material financial distress, about to fail, and could pose a threat to the financial stability of the country. This is the only test by which all four of the SIFIs were judged.

Under the other test in Dodd-Frank, the Council can look at the activities of the company, regardless of whether the company is about to fail, and then judge whether those activities are systemically risky and pose a threat to the financial stability of the United States.

The Council used the material financial distress test in designating all three of the insurance companies as SIFIs rather than the activities test which, as I explained in my written testimony, I had advocated.

Now I would like to focus on what comes next for the three insurance companies SIFIs. Had the Council used the activities test as I had advocated, it would have let the SIFIs, other companies, and regulators know what it was about the companies' risk activities that needed to be addressed in order to remove whatever threat to the U.S. financial system the companies might pose. As a result of the Council's failure to undertake this approach, the companies and their primary regulators are in the dark.

It is my hope that the insurance SIFIs are not stuck in a "Hotel California" and that the Council will begin to provide guidance to the companies and their primary regulators as to what the companies can do to lessen their systemic risk footprint, and not just so they can exit Fed supervision but so whatever systemic risk they pose can be mitigated and they will no longer pose a risk to the entire U.S. financial system.

From my perspective, each year that a SIFI is, again, judged to still be a SIFI, it is no longer a reflection on that company. Rather, it becomes a measure of the success and effectiveness of the Council and of the Fed supervision. If we are not improving them, and the SIFIs are, year after year, still found to have systemic risk, what will the labeling of these companies as SIFIs have achieved?

As previously stated, I think the Council should provide some degree of guidance as to the SIFIs as to how they could mitigate their systemic risk, and I will continue my efforts to encourage the Council to provide such guidance.

Thank you, Mr. Chairman. I am happy to answer your questions.

[The prepared statement of Mr. Woodall can be found on page 56 of the appendix.]

Chairman LUETKEMEYER. Thank you, Mr. Woodall. This panel is going to get a blue ribbon with a gold star, because every single one of you stayed within your 5 minutes. That is a first for me in my 7 years of being here. Well done, gentlemen.

Let me begin the questioning this afternoon with Mr. Sullivan. Dodd-Frank requires the Fed to develop a domestic capital standard that you discussed a minute ago. Where are you in that process? And when do you expect we can receive the final capital standard?

Mr. SULLIVAN. Thank you, Mr. Chairman. We are not being driven by an artificial timeline to develop that standard. Right now, in terms of our progress, we continue to solicit views from external parties, some degree of internal deliberation, as we prepare to present to the Board an array of options that could be considered for a domestic capital standard. So we don't have a specific timeframe; we continue to work at it. And as I said in my testimony, we had a very open door in terms of soliciting the views from many, including our friends in the State regulatory communities and others.

Chairman LUETKEMEYER. So it could be anywhere from 2 months to 2 years, is that what you just said?

Mr. SULLIVAN. I don't think this is something you want to hurry or rush along. I think this is something about which we want to be very careful and thoughtful and deliberate.

Chairman LUETKEMEYER. I think that begs the question, then, what we would like to see is a domestic standard set first before we go to the international standard. Would you commit to doing that as well?

Mr. SULLIVAN. Well, ours is an obligation under the law to fulfill our obligations under Dodd-Frank. The standard setting at the IAIS I would differentiate insofar as Director McRaith—

Chairman LUETKEMEYER. Are we are not putting the cart before the horse? Are we not going to sort of endanger your ability to do your job if the international group decides to set capital standards, and suddenly you have to take that into consideration with your standards. Is that not going to happen? Isn't that a possibility?

Mr. SULLIVAN. We are not obligated to enact anything—

Chairman LUETKEMEYER. I didn't say you are obligated. I asked if that is a possibility?

Mr. SULLIVAN. I suppose, from a timing perspective, it could play out that way.

Chairman LUETKEMEYER. Therefore, my question is, Mr. Sullivan, are you willing to put in place the domestic standards, before you allow the international standards, or agree to putting international standards in place?

Mr. SULLIVAN. Our development of the domestic standards will be done on our timeframe after a thorough and deliberative process through the Board. And anything that we consider internationally will have to meet the test of, is it appropriate for the U.S. market? Is it appropriate for U.S. consumers?

Chairman LUETKEMEYER. Well, it is hard to understand how it could be appropriate, sir, if you haven't gotten them in place yet, whenever you try to make a determination on an international basis.

Mr. McRaith, would you agree with that statement?

Mr. MCRAITH. Forgive me, I didn't get every word of your comment.

Chairman LUETKEMEYER. Okay. Mr. Sullivan thinks that we need to take into consideration—well, I don't want to put words into Mr. Sullivan's mouth, so let him rephrase his comment.

Mr. SULLIVAN. My statement was that we would develop our domestic capital standard on a timeframe that we deem appropriate, and that we would consider any international standards for adoption, but they would only be adopted in the United States if they were appropriate for U.S. markets.

Chairman LUETKEMEYER. If they were appropriate for U.S. markets, that is the concern I have. Mr. McRaith?

Mr. MCRAITH. I support Tom Sullivan's comments. I think we have two separate issues that are at play, one is the global standard. What we are doing collaboratively is ensuring the U.S. leadership in that conversation is provided domestically, which has the force of law and a requirement the Federal Reserve should proceed in a way that is deliberative and tailored to the companies under their supervision.

Chairman LUETKEMEYER. Further, I want to congratulate and thank Mr. McRaith and Mr. Sullivan for being open and available to myself and this committee. I know that part of our job here is not just legislative, it is also oversight, and to work with Mr. Sullivan and the Fed and Mr. McRaith, the FIO, to sort of peek over their shoulders and watch what they are doing, especially with this international discussion going on. They have been very cooperative and very forthcoming, and I want to thank you for that.

Mr. Woodall and Mr. Huff, you guys are working with the SIFIs and have long comments in your opening statements about it. You know, Mr. Woodall, you talked about the material financial stress and not using activities to mean, because they don't do that, they can't figure how the how to de-risk. This is extremely important. This is a really big problem, because how can you tell somebody is doing something wrong, but you don't tell them how to fix the problem. Would you elaborate just a little more?

Mr. WOODALL. That restates it beautifully, because if the companies don't know what they need to do to not be a SIFI, then they are in the dark, the regulators are in the dark, then we haven't really accomplished anything.

Chairman LUETKEMEYER. It is kind of like if you have a teenage driver, and they keep running in the ditch, you don't tell them you have to turn to the left once in a while instead of keep turning to the right to get into the ditch, they will never get out of the ditch, will they?

Mr. WOODALL. Exactly.

Chairman LUETKEMEYER. I am out of time. So Mr. Huff, hopefully you will be able to answer my question regarding that shortly.

Let me recognize the gentleman from Missouri, my good friend and colleague, and ranking member, Mr. Cleaver, for 5 minutes.

Mr. CLEAVER. Thank you, Mr. Chairman. I want to continue along the lines the chairman established. Let me first recognize—I didn't see him earlier—Senator Ben Nelson from Nebraska. I appreciate you being with us here today.

Mr. Sullivan, I think I understood every word you said. I am just a little concerned about it, and I am wondering whether or not this won't end up being a major mistake. It would seem to me that, you know, I want to set the rules in my house first before I started passing city ordinances, regulating what you can do—I mean, the curfew is set in my house, because if we end up being, somehow, ending up placing our standards based on international standards, it may put some kinds of undue pressure and influence on our insurance companies.

And I know, I heard what you said, I just think it is difficult to take into account what is happening internationally if we are going to put this framework together first.

I may be asking the same question in a different fashion. Are you concerned about it at all?

Mr. SULLIVAN. We are obviously concerned, but we are—we have a seat at the table, as Director McRaith pointed out in his testimony, the U.S. insurance market is the world's largest insurance market. I fail to see how an insurance standard would be widely accepted around the globe if you ignore the world's largest insurance market.

So collectively, with representatives from the NAIC, and Director McRaith, and the Fed, we are at the table at the IAIS working to fashion and craft an international standard that we believe will be appropriate for U.S. insurance markets and U.S. insurance consumers. That work has, thankfully, because of the good efforts of Director McRaith and Director Huff and others, been extended. Some of the timelines have been pushed out, as the chairman noted in his opening statement.

So I think we have some room. I don't underestimate the gravity of what you have pointed out, Mr. Cleaver, but I think if we continue to work together and represent the United States at the international fora, we will hopefully get to something that will be acceptable.

Mr. CLEAVER. I am assuming that all four of the witnesses agree with some variance of that?

Mr. MCRAITH. Congressman, one point that I think is important to make is the alternative of not participating in the global discussions would be far more detrimental to U.S. interests than us being involved as we are right now, working together to assert and provide U.S. leadership in those fora. That is exactly what we are doing. When the Federal Reserve develops its rule, it will be tailored appropriately following, as Mr. Sullivan said, a lot of good work. That allows us to further lead the conversation. Right now, we want to be sure in these early days of development that we are very clear and assertive about the U.S. views on these important topics.

Mr. CLEAVER. Okay. I would like to have more conversation on this, but I want to go to Director Huff. The Missouri insurance industry is, right now, about a $34 billion industry, with over $112 billion in State-chartered financial institutions. What condition would you say the State's insurance agency is in? I know somebody probably thinks it is a softball thrown up in the air, please view it as such.

Mr. HUFF. Thank you, Congressman. The Missouri market is very competitive at this point in time in most lines of business. Workers' comp, in particular, we have over 320 active writers in the State and insurers are actively competing for employees to offer workers' compensation.

Our auto market has just been rated by an outside source as the seventh most competitive in the United States. In the auto industry, again, we have about 175 active writers, so those markets are very competitive.

The health side, not so much. We are struggling on our health insurance side of having active writers in the market, and really 4 health insurers control almost 90 percent of the market. That is an area we struggle in.

The other area that we have quite a bit of expertise in is the reinsurance market. We are home to two of the largest reinsurers in the world. And at this point, due to the redomestication of a reinsurer, about 40 percent of all the life reinsurance in the United States is written out of a Missouri domestic.

Mr. CLEAVER. Thank you. I yield back, Mr. Chairman.

Chairman LUETKEMEYER. The gentleman's time has expired. With that, we go to the gentleman from Florida, Mr. Posey, for 5 minutes.

Mr. POSEY. Thank you very much, Mr. Chairman. And I thank all of you for being here today. I really appreciate you taking the time to testify before us today.

My question is for Mr. Huff. In your written testimony—it wasn't in your oral testimony; I understand that time constraints wouldn't allow you to expand too much—you noted that the National Association of Insurance Commissioners, which consists of chief insurance regulators from the States, which we know are political bodies that actually balance their budgets, and regulate in a way that we could hope the Federal Government might achieve some day—they do a lot better job of regulating actually—is supportive of House Resolution 1478, the Policyholders Protection Act.

Mr. Chairman, at this time I would also like to submit an additional stack of letters of support for the Policyholders Protection Act that has been received by my office.

Chairman LUETKEMEYER. Without objection, it is so ordered.

Mr. POSEY. I would also like to echo Mr. Huff's testimony that this bill enjoys wide support from the States, the consumers and the insurance industry and the people that it protects. This legislation is a bipartisan effort introduced with Representative Sherman. It would limit the ability of Federal bank regulators to raid certain solvency threatening insurer assets as a source of strength for banks.

My question, Mr. Huff, for you is that, I hope you could explain to us in a more detailed manner how this legislation is important to protecting insurance consumers and why policyholders need this protection?

Mr. HUFF. Thank you, Congressman. State insurance regulators strongly support your bill, the Policyholder Protection Act, mainly because it preserves our ability to protect consumers within complex financial firms so that policyholder dollars necessary to pay claims, for instance for a damaged house, or even for a life claim for a deceased breadwinner, those claims are not jeopardized by complex bets, risk taking or poor management elsewhere within the firm. The bill ensures the State insurance regulators continue to have the ability to specifically protect insurance-related assets in order to pay claims when they come due, and the policyholders remain protected from undue harm.

Insurance regulators have long had the ability to wall off insurance company operating entities within large diverse financial groups from the risk posed by other affiliates to protect policyholders. And your legislation guarantees a level playing field and confirms that authorities, and existing State law, and Federal law governing bank holding companies, apply to insurers organized as savings and loan holding companies. It also clarifies insurance regulators' authority to protect policyholders during a resolution of an insurance company or its affiliate. Thank you for sponsoring the bill.

Mr. POSEY. I thank you for your comments. A question for any of the four of you, have any of you heard of TRG, an insurance company? They sold health insurance in 49 States, every State but their own State. People died because they didn't pay claims. They paid their premiums, but the insurance company just never paid any claims. They were protected from the States for years under ERISA; the Federal Government did nothing, nothing, zero, nada, zilch, to stop the perpetrators of this horrendous crime against honest, law-abiding citizens who were just trying to insure loved ones for future misfortune, health misfortune, which they had.

There never was any justice until 13 different State agencies got together for the first time in history, crossed State lines to enforce crimes, insurance crimes and—pretty precedent setting matter, the point is that the State regulators made it happen, the Federal regulators did nothing.

And so, I learned a lot from that experience. And I cannot thank the State regulators enough for their dedication, and actually their ability to get things done, and protect the consumers in ways that the Federal Government has never been able to do. They write plenty of regulations, but there are Federal statutes that would have made those perpetrators serve life in prison because people died for them failing to pay for the coverage, yet they never pursued the cases again them. Thank you very much, Mr. Chairman. I yield back.

Chairman LUETKEMEYER. The gentleman's time has expired. We go to the gentlelady from New York, Ms. Velazquez. She is recognized for 5 minutes.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Director McRaith, one area of the market which is particularly important to my constituents is affordable flood insurance. As you know, many homeowners in New York City faced enormous rate hikes in the aftermath of Superstorm Sandy. What role does the FIO play in studying the flood insurance market and what suggestions do you have to keep it affordable?

Mr. MCRAITH. Treasury certainly has an interest in the flood program. As you know, the Treasury lends money to the National Flood Insurance Program (NFIP). The NFIP is administered by FEMA within DHS, and we—and they, of course, do their best in that work every day. To the extent that they have asked for or sought our assistance or our perspective, we have been happy to share that.

Ms. VELAZQUEZ. Thank you. Mr. Sullivan, the State risk-based capital regime is focused on policyholder protection. Yet, the Federal Reserve supervisory system takes a far more macro approach to protect the safety and soundness of the entire financial system. How can the Federal Reserve establish a supervisory framework for insurance companies to both protect policyholders and preserve financial stability?

Mr. SULLIVAN. Thank you, Representative. Ours is a macro role, and we do look at our role as that of looking at the entirety of the enterprise. As I said in my opening statement, we don't intend to replicate the work of the States, and we will defer. We are absolutely deferential to the States in their mission to protect policyholders. I was once a State regulator; I take that very seriously. And I think the State regulators are doing a fine job of protecting policyholders.

Ms. VELAZQUEZ. Thank you. Mr. Huff, would you like to comment?

Mr. HUFF. Yes, we have a good working relationship with the Fed. You may know Missouri is the only State with two Federal Reserve banks. And, so, we have a Kansas City Fed and the St. Louis Fed and we also have a good working relationship with the Fed here in Washington. But we do take protection of policyholders; that is our number 1 priority, and, of course, building competitive and maintaining competitive markets. But everything we do in terms of financial regulation starts and stops with protecting policyholders, whether it is looking at the—strengthening our RBC system, and as we work on capital standards, or if it is our work related to reinsurance collateral and our work on covered agreements. So we do start and stop with policyholders.

Ms. VELAZQUEZ. Thank you. Mr. Huff, in 2013, then-New York's Superintendant of Financial Services found life insurers were exploiting the State-based regulatory scheme to inflate their books to the tune of $48 billion. This revelation has troubling similarities to the issues surrounding mortgage-backed securities that precipitated the 2008 financial crisis. Don't these practices threaten the legitimacy of the State-based insurance regulatory structure and, in turn, fuel calls for more Federal involvement?

Mr. HUFF. Just to clarify, were you talking about the New York study on captives?

Ms. VELAZQUEZ. The New York Superintendent of Financial Services found life insurers were exploiting the State-based regulatory scheme to inflate their books; a New York Times article.

Mr. HUFF. Right, I think you are talking about the New York Times article now about the use of captives. And we have made a great deal of progress. As I said in my opening comments, really the origin of captives was, in large measure, to address admittedly excessive reserves. Primarily when we took a look at it, in term insurance and universal life insurance with secondary guarantees.

So what we did was we began with a study of life insurers in 2012, we finished a White Paper that outlined these issues in 2013. And then in 2014, the NAIC adopted a comprehensive reinsurance framework such that a life insurer would be allowed to take financial credit for the reinsurance transaction with its captive only if certain financial criteria are met.

And a very consistent reserving method was developed and adopted by the NAIC, you may have heard of it, Actuarial Guideline 48, and it was effective on 1/1/15 on all new policies issued. So we have taken very certain action on these life insurer captives. Of course, our permanent solution to address this is our principle-based reserving methodologies.

Ms. VELAZQUEZ. So you are confident that these issues have been taken care of?

Mr. HUFF. I am confident we are on a path to take care of them, yes, ma'am.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Chairman LUETKEMEYER. I thank the gentlelady. Her time has expired. With that, we go to the gentleman from Pennsylvania, Mr. Rothfus, for 5 minutes.

Mr. ROTHFUS. Thank you, Mr. Chairman.

Mr. Sullivan, Chair Yellen, in testimony before the House Financial Services Committee this year, stated that the FSOC has not discussed pursuing an activities-based systemic risk review for insurance companies. What is the rationale for not pursuing an activities-based systemic risk review for insurers?

Mr. SULLIVAN. I think you should direct your question to the Chair. She is the seated member of the FSOC. I believe—

Mr. ROTHFUS. Has the FSOC conducted a study or an analysis that demonstrates that it is inappropriate to use an activities-based approach to regulating systemic risk for insurers?

Mr. SULLIVAN. May I have the question again? I'm sorry.

Mr. ROTHFUS. Has the FSOC conducted a study, or an analysis, that demonstrates that it would be inappropriate to use an activities-based approach to regulate a systemic risk review for insurers?

Mr. SULLIVAN. I am not aware of what the FSOC has or has not conducted for studies.

Mr. ROTHFUS. Mr. Woodall, in your written testimony you discuss the benefits of incorporating an activities-based systemic risk approach and the exit ramp that should follow based on activities or a combination of activities identified as riskier than others.

Both the Treasury and the Fed have testified that a path to de-designation is available, but have been hesitant to provide details. Do you believe that a SIFI designation exit ramp exists?

Mr. WOODALL. As I said in my statement, I think that it should exist, but I think right now the companies don't really know where that exit ramp is, and whether it is multi-lane or not, as it has been called. It is hard to find. I think going back to your other question about the activities based, I think on the other side of the question you ask, FSOC has looked at the activities thing in regard to asset managers, and they have essentially set aside making any further designations on any basis until they can look at the activities of the asset management industry as a whole, and that is what they are in the process of doing right now. So I am encouraged that they are starting to look at the activities based.

Mr. ROTHFUS. Mr. McRaith, in January Congress passed The National Association of Agents and Brokers Reform Act of 2015, better known as NARAB II. This bipartisan legislation was meant to streamline licensing compliance measures for insurance agents while maintaining a high standard of State-based regulation.

As you know, NARAB II won't go into effect until a board is selected and appointed. Though the President signed this bill 9 months ago, it appears that little progress has been made in appointing a board, and the process of reform that Congress worked hard on appears to be at a standstill.

Our chairman, Mr. Luetkemeyer, wrote to your agency expressing his concerns and inquiring as to NARAB II's delayed implementation. I was disappointed that Treasury's response to his letter was noncommittal and failed to provide a meaningful update on the implementation process. Can you provide us with an update on the NARAB II board appointments?

Mr. MCRAITH. Congressman, as you know, the law requires 13 Presidentially-appointed Senate-confirmed board members. We received applications—the White House has received applications. Candidates are being considered, evaluated, vetted, and I am sure at an appropriate time the White House will forward those—

Mr. ROTHFUS. Has the Treasury Department completed its work on the vetting process?

Mr. MCRAITH. We have done what we can to support the effort. I think the Administration, which supports NARAB as an objective, continues to see the value and wants to see NARAB initiated as soon as possible.

Mr. ROTHFUS. Back to Mr. Woodall again. You have complained that your role in international negotiations as the only voting member of FSOC with insurance expertise has been constrained. Why do you think that is?

Mr. WOODALL. Essentially, what they call Team USA or the gentlemen to my right here, the three people who are involved at the IAIS. I have a duty as a member of FSOC to monitor international developments in insurance and accounting. That is the way it works. Obviously, Mr. McRaith has the charge, as he said, to represent the United States at the IAIS, as appropriate.

I felt that being the insurance expert on FSOC, I needed to be involved in the room where the systemic issues are being discussed, and that is what we talked about 2 years ago when I was before this subcommittee. At that time, several people said they wanted me in the room. I tried to make an effort to get in the room.

Mr. ROTHFUS. Do you believe that the FSOC approaches international negotiations on insurance matters with a sufficient understanding of the industry?

Mr. WOODALL. I am supposed to be the expert to try to advise FSOC. And right now, I can't say that FSOC has that comprehensive a view of what is happening at the international level. I think there is a feeling that the international may be driving that car, as far as what is being done at the international level coming down into the other. Because, as you know, when our people are at the FSB, and they make commitments to carry out something that the IAIS has done, as has been said many times, they can't guarantee it, but they consent, it is a consensual process.

That is what happened with the three companies, the insurance companies that were designated as global SIFIs. And two of those were before we ever even said they were a U.S. SIFI. And I really feel like we have a situation where the international people have been driving that car.

Mr. ROTHFUS. I yield back.

Chairman LUETKEMEYER. The gentleman's time has expired.

We now go to another gentleman from Missouri, Mr. Clay, for 5 minutes.

Mr. CLAY. Thank you, Mr. Chairman. And thank you, gentlemen, for being here.

Let me start with Mr. Sullivan. In its development of capital standards, is the Federal Reserve attempting to draw a distinction between traditional or core insurance activities versus nontraditional or non-core activities?

Mr. SULLIVAN. So as we construct a domestic capital regime, we will be looking at the totality of the enterprise, including insurance activities and nontraditional, or non insurance activities, because we are charged, under the law, with developing a comprehensive consolidated capital framework. So we will be looking at the totality of the enterprises we supervise.

Mr. CLAY. Stress tests serve as an effective tool for measuring the health of financial institutions. Will the Federal Reserve engage in stress testing for insurance companies?

Mr. SULLIVAN. Yes, likely at a minimum for the designated firms, and in consultation as prescribed under Dodd-Frank with the Federal Insurance Office.

Mr. CLAY. Will these tests specifically look at systemic circumstances and stresses to the broader financial system that could occur simultaneously with stresses to the supervised firm?

Mr. SULLIVAN. It is too early to speculate on that, but probably.

Mr. CLAY. What do you think are the differences between testing stresses at an insurance company versus a bank?

Mr. SULLIVAN. The business models are very different. And, so, therefore, whatever stress testing regime we design needs to be appropriate and designed for the differences in the business models.

Mr. CLAY. Thank you for your response.

Mr. Huff, as the International Association of Insurance Supervisors continues to work on the development of capital standards, some have raised concerns about its application in the United States.

Mr. Huff, as a State insurance commissioner, can you discuss the steps that your department, for example, would take in reviewing any internationally-developed standards and discuss what actions would need to be taken for those standards to apply in Missouri?

Mr. HUFF. Thank you, Congressman Clay. It is important to remember that nothing that the IAIS does in terms of international capital standards, or any of the work they do for that matter, is automatically implementable in the United States for insurance firms. Unless the NAIC, with State regulators working collectively through the National Association of Insurance Commissioners, adopts those standards through its open and transparent process, then it would not be applicable to the insurance market, or unless the Federal Reserve decides to adopt those standards for their limited portfolio of the thrift holding company insurers, or the systemically importantly financial institutions as designated by FSOC. So nothing would come directly from the IAIS.

Mr. CLAY. I see. Mr. Woodall, you have expressed concerns with international developments related to insurance, but as you know very well, while the Federal Government can certainly agree to reforms at the international level, domestic implementation would largely occur State by State. Even for implementation that would occur at the Federal Reserve Board, there would still be a notice-and-comment period prior to implementation.

Can you please discuss in more detail the process that any State insurance commissioner would go through when deciding whether or not to implement international reforms, in full or in part?

Mr. WOODALL. I am not a regulator at this point. Fifty years ago, I was. But I know how it works and I know that each State has to look at it to see whether or not that is what they want to do. I think more than likely, some of these things won't affect that many States because there won't be that many States that have companies that might be subject to some of these things.

Now, whether that would go down to non-internationally-active companies, it is still a question as to how far some of the recommendations that come out of the international level will go.

Mr. CLAY. Thank you for your response.

Mr. Chairman, I yield back the balance of my time.

Chairman LUETKEMEYER. I thank the gentleman from Missouri. With that, Mr. Pearce from New Mexico is the next gentleman to be recognized, for 5 minutes.

Mr. PEARCE. Thank you, Mr. Chairman. I appreciate each of you being here. I am trying to sort through this situation that we have faced.

Mr. Sullivan, you mentioned to Mr. Rothfus that he needed to direct his question elsewhere, and we in anticipation of that did just that. We asked the Chair of the Board of Governors of the Federal

Reserve System, Janet Yellen, after her last appearance here about a couple of things regarding this particular issue. And we asked, does the FIO communicate and coordinate, pre-plan policy objectives with independent State regulators, insurance regulators who are responsible for insurance supervision in the United States.

Her response back was Team USA—that, yes, we approach it as a team, and NAIC takes the lead in coordinating the views and comments of State regulators into the the feedback the U.S. members provide on IAIS standards.

So my question to you is, is it safe to assume that the Fed does not propose any ideas before the IAIS or FSB without NAIC's approval or previous knowledge of those positions? So is it actually Team USA, and I am visualizing the Tour de France, the postal team on bicycles are riding and high-fiving each other, but the yellow jersey is worn by the NAIC. Is that the way it is going?

Mr. SULLIVAN. We continue to work hard at our collaborative efforts—

Mr. PEARCE. You are far enough behind the yellow jersey that you can hardly see them over the hill, huh?

Mr. SULLIVAN. I would tell you that it takes hard work and good old-fashioned shoe leather to be committed to the process.

Mr. PEARCE. Mr. McRaith, do you have an opinion about the communication process and the NAIC taking a lead?

Mr. MCRAITH. The key for our work is that we are working together building consensus as a group.

Mr. PEARCE. I didn't ask that. Do you agree with the assessment that nothing goes before it is run by the NAIC?

Mr. MCRAITH. As a practical matter, and as the GAO noted in its report about 7 weeks ago, we are all working together to develop—

Mr. PEARCE. You are just not going to answer the question. I will quit asking the questions if you don't want to answer.

Mr. Woodall, Mr. Rothfus brought up, he was kind of dragging into this direction with the crafting of international standards. I think Mr. McRaith said that we are trying to craft international standards that will be acceptable to the U.S. market. Mr. Rothfus sort of got into this. Is it your opinion that we were actually doing that, is—are we crafting standards that will be acceptable to the U.S. market, I mean, he led in with it is a big piece of world equation and that. Is that actually occurring?

Mr. WOODALL. It is really hard for me to say, because as I mentioned, I am not a member of Team USA.

Mr. PEARCE. Have you ever objected—have you ever dissented on any of these comments before?

Mr. WOODALL. Which comments, sir?

Mr. PEARCE. Anything along this track that says, hey, we are running a nice, tight ship here, and we are Team USA and we are moving right along. That is nothing that you have ever—

Mr. WOODALL. Well, no, I have just tried to get in the room with them and have not been successful.

Mr. PEARCE. Okay. Mr. Huff, you said that the protection of the policyholders is your number one priority. Is that the viewpoint shared by the Feds and FIO?

Mr. HUFF. I will let the Fed and FIO speak for themselves, but our number one mandate continues to be the protection—

Mr. PEARCE. But you heard my comment from the chairman that you are the one taking the lead here. You are wearing the yellow jersey, everybody is following you. Is that actually occurring or is that not?

Mr. HUFF. We certainly are—

Mr. PEARCE. I don't know if are you afraid of what is going to happen after you answer the question.

Mr. HUFF. I will tell you one place we are taking the lead—if I could give you an example of where we are taking the lead, we are moving forward with the group capital calculation, State insurance regulators are getting together and moving forward. We will have a concept paper later this year for our November meeting that will be at the National Harbor in November.

Mr. PEARCE. You also made the comment that no case has been made, and you don't want the system to compromise the State systems. Is that a viewpoint you would share, Mr. McRaith? You are trying not to compromise the State systems that Mr. Huff said have been working pretty well. And no case has been made to overturn them for international standards?

Mr. MCRAITH. Absolutely, the global standard setting does not get into the structures or the architecture of a country's regulatory system. In our view, the State system works very well. I was a former State regulator, as were my colleagues on this panel.

Mr. PEARCE. This is true confessions. Several of you were apparently in the State regulatory system. Okay, thanks. I yield back, Mr. Chairman.

Chairman LUETKEMEYER. The gentleman's time has expired. We now go to the gentleman from Texas, Mr. Green, for 5 minutes.

Mr. GREEN. Thank you, Mr. Chairman. I thank the ranking member as well. And I thank the witnesses for appearing.

Mr. Woodall, you have raised questions about SIFIs and how they can be delisted. Is your question how can a specific entity, company, corporation be delisted, or is there a means by which you can have a standardized methodology in place for delisting?

Mr. WOODALL. So far, we have just talked about the individual SIFIs. And I think in that case what I was saying is that these individual companies don't have a road map as to how to get off. Now there is one; we talked about the insurance companies, the GE Capital is the fourth SIFI that was designated. And as you probably know, it is public information, they are in the process of getting rid of all their financial activities, and probably will lose their SIFI identity. But I am not sure that insurance companies are in the position to do the nuclear option and get rid of all their financial business in order not to be a SIFI.

As far as a group—

Mr. GREEN. Let me do this, because I would like for Mr. Sullivan to respond, I am interested in hearing his take on it. Mr. Sullivan, Mr. Woodall makes a point that because of the nature of the business of insurance companies, delisting becomes a bit more difficult than for a GE Capital. How do you respond to that?

Mr. SULLIVAN. Representative, mine is to design the regulatory regime and architecture for firms after they are designated by the

FSOC. So what I am doing in my day job is doing just that, making sure that we put together a regulatory regime designed for firms designated by the FSOC.

Mr. GREEN. So no one on this panel can address Mr. Woodall's question then, I take it?

Mr. MCRAITH. Actually, Congressman, just to be—I think it is important to be factual in this conversation. The firms that are designated by the Council, after following months of engagement with the firm, thousands of pages of analysis, hours spent with the firm by all Council members, the firm designated receives several hundred pages of analysis that provides detailed and explicit statements about where the Council sees risk or threats to financial stability in the firm. So the firm does have a very clear sense of the basis for the Council's determination.

Mr. GREEN. I understand. But Mr. Woodall seems to be asking another question, not what is it that caused the company to become a SIFI. He seems to be asking what can be done so that the company can no longer be a SIFI?

Mr. WOODALL. That is the difference, that is the next point.

Mr. GREEN. Mr. Woodall, you have to let me have a minute here now. My time is very limited.

So how do you address his question? I think he raises a good question, and I would like to hear a good answer.

Mr. MCRAITH. The Council has an annual review process for firms that have been designated. That process was enhanced this year based on stakeholder and public comment and comments from Members of Congress as well. So each firm designated has an opportunity to come to the Council, provide information about how it has changed its approach over the course of the year. And throughout the year, the Council and its staff and members who serve on the Council have an open-door policy whereby a firm designated can come in at any time, share any information and provide any insight they would like to.

Mr. GREEN. I see. Let me just make this comment. It seems to me that we are talking about something similar to strict liability. As you know, we have negligence and intentional torts, but you can also be liable just because of the inherent nature of what you do.

And I think Mr. Woodall is getting to this point, he doesn't believe that insurance companies are inherently dangerous to the extent that they become SIFIs and they are never going to cease to be SIFIs.

So the question becomes—and I am going to visit more with people about this, I am just curious now because of the way he raised the question. How do they—we are new at this, we are in our infancy. All of this is fledgling in a sense, and given that we are in our nascency, these kinds of questions do have to be answered. And perhaps with more opportunities, we will get some answers, but I am still curious of Mr. Woodall's question of moving from designation to no longer being listed or de-risking is a case with GE Capital. Thank you very much. And Mr. Chairman, you have allowed me 11 more seconds than I deserve. I yield back.

Chairman LUETKEMEYER. I am always glad to accommodate the gentleman from Texas with a couple of extra moments for his wonderful insights. Thank you, Mr. Green from Texas. With that, the gentleman from Kentucky, Mr. Barr, is recognized for 5 minutes.

Mr. BARR. Thank you, Mr. Chairman. And I thank the witnesses, as well. There has been much discussion outside this hearing, and, of course, today in this hearing about the sequencing and the timing of the international capital standards and our new domestic capital standards under the fix to the Collins Amendment.

For Mr. Sullivan, I would like to kind of drill down a little bit more on the timing. I know you said we are working on our own timeline. Do we have any kind of ballpark timeframe in terms of the draft of capital standards? And give me an idea of the process. Is there going to be a notice of proposed rulemaking?

Mr. SULLIVAN. Yes, we are committed. We said to this committee and other Members that we are committed to a formal rulemaking process. We will not be doing it by order, so we will publish a notice for proposed rule. We will solicit interested party commentary when we reach the point where we actually have the architecture and design for the capital framework better nailed down.

Mr. BARR. Mr. McRaith and Mr. Sullivan, how much does your work at the FSB and IAIS influence the development? You say you are very deliberative, and you are seeking input, but how much does that work over there influence the development of the capital standards here?

Mr. SULLIVAN. I will go first, but I would say that when we attend international fora, Representative, other regulators around the globe are quite interested in what the U.S. view is. As Director McRaith pointed out, we are the world's largest insurance market, so I think the rest of the global regulatory community would stand up and recognize what the United States does. So I think it does go back to the chairman's earlier questions around the importance of getting things right. And we are cognizant of that, and we want to make sure we are deliberate and we do nail it down.

Mr. BARR. Can you give me an idea of the progress of the international capital standards, because we are hearing that whereas you are on your timetable here and it is very deliberative, that the IAIS is pushing ahead. So is the risk then that the sequencing is going to be backwards?

Mr. SULLIVAN. We always have the fallback that we don't have to adopt an international standard if it is not suitable for our market, right? We have said that a number of times today and in the past. With that being said, sequencing here, one is a fulfillment under the law, what we do in terms of fulfilling our obligations under the law. The other is standard setting. I would describe the standard-setting climate as much more evolutionary because it has to be.

Director McRaith has used the term when talking about the international capital standard, ICS 1.0, and how ICS 1.0 will look much different or may look much different than ICS 10.0. I would share that view, that the developments in the international standard need to evolve more over time, over a much longer time period. And we were successful in removing some of the time constraints that were in some of the goal statements that were previously published by the IAIS.

Mr. BARR. I would just encourage you all as representatives of Team USA to be prepared to back off, and push back from the IAIS negotiating table if you perceive them getting ahead of you all.

Let me just shift over to Mr. Huff really quickly. One of your colleagues who was before this committee, Kevin McCarty, the Florida insurance commissioner, said in a Senate Banking Committee hearing earlier this year that in regards to international capital standards being developed, and the historical differences between the United States and European approaches, when you try to harmonize those two, you are creating a potential for great disruption in the delivery of different services in the marketplace and potential rise in the price for the consumers in the United States that potentially jeopardizes the availability of products.

And so, to Mr. Huff, how are State regulators and the NAIC working with the Fed to make sure that domestic capital standards are finalized before completion of the international capital standards?

Mr. HUFF. Yes, thank you for the question. We are actively involved at the IAIS along with the Fed and FIO, and with the State insurance regulators and a full complement of NAIC staff. So it is important that we continue that work, even when we reach disagreements with the IAIS process, because we always do have that ability to walk away.

But what we are doing—the State regulators are doing is we are moving ahead with our own work on a group capital calculation to be used as a consistent regulatory analytical tool for all U.S. insurance groups. And by building this calculation tool, we are able to assess group capital and then make—and have an open forum with—an open and transparent forum with industry and with consumer groups an then allow the Fed and FIO also to participate as we build that tool. So that will help us as we inform our work at the IAIS.

Mr. BARR. Thank you. I know Mr. Sullivan testified they are collaborating with you, appreciate you collaborating with them. Team USA, go first. Thank you.

Chairman LUETKEMEYER. I thank the gentleman. Your time has expired. Understanding we have votes at 3:45 as scheduled, I think we probably have time if everybody stays within 5 minutes here to get everybody in today. So with that, I recognize the gentlelady from Wisconsin, Ms. Moore, for 5 minutes.

Ms. MOORE. Thank you so much, Mr. Chairman. I want to thank the panel for this very important hearing. I guess I want to follow up on my colleague. Mr. Huff, I note that in your credentials you served as a State insurance commissioner from Missouri, as well as served on the FSOC.

Pardon me, I wasn't here for the beginning of the hearing, so just indulge me, perhaps you have already answered this question. You have indicated that the FSOC perhaps does not have the knowledge base and a—doesn't see the dissimilarity between the insurance industry and the banking industry to perhaps serve—to perhaps designate folks as SIFIs or to undesignate them as SIFIs. And I am wondering what you think ought to be done to enable the Federal Office of Insurance to, and the FSOC, to have more insight into what ought to be done with regard to regulating the insurance industry?

Mr. HUFF. Thank you for the question. I have not yet spoken about my FSOC service, and I did serve 4 years. I was one of the original members of FSOC as a nonvoting member representing State insurance regulators from fall 2010, and then I served until September of just last year. And I did issue a dissent, a nonvoting dissent on the Prudential designation. And I echo Mr. Woodall's comments on the exit ramp, if you will, for the designation.

So I do believe it is a failure of FSOC to not set forth a clear rationale for the reasons for designation, because really, they are not giving the company an ability to de-designate; but more importantly, FSOC is not giving the primarily regulators, and in the insurance space, that is the State regulators, not giving the State regulators the identification of those risks that need to be mitigated.

We don't yet know what the impact will be of a designation because the capital standards are still pending. But at some point additional capital standards will be applied to those firms that are designated, and then we will have a distortion in the marketplace of firms competing head to head, one against each other, one with a different cost of capital. We don't know how significant that will be, but we think it is only fair that FSOC come out with a clear exit ramp, not only for the company, but for State-based regulators.

Ms. MOORE. Thank you for that. And this is for Mr. Woodall, or maybe Mr. McRaith. I am very interested in private mortgage insurers who are recapitalized. I believe that there will continue—there ought to be at least a continued option for placing private capital in the first loss position. Unfortunately, there has been a discussion around here of completely destroying the GSEs, and I don't believe there is enough private capital to fill that gap. So the FIO report outlines some of the past problems, issues. But I am really interested in what you think the future is going to look like, what it ought to look like with regard to private mortgage insurers.

Mr. MCRAITH. The private mortgage insurers suffered greatly through the crisis. They are in a stronger position right now, and, in fact, I think some recent entrants into the market are domiciled in your home State.

Ms. MOORE. They are in my city.

Mr. MCRAITH. Right. And we are pleased to see that. We do want to see more private capital in that space. It promotes home ownership in a way that supports people of low and middle incomes when they seek to purchase a home. That is excellent public policy and a goal that we all share. In terms of the housing market more broadly, and the housing finance system, I think would defer to my colleagues at Treasury who are more expert in that conversation.

Ms. MOORE. Okay. Just one quick—I have 30 seconds left. I am really interested in the auto insurance—I guess I am interested in, Mr. McRaith, why, of your statutory responsibilities, you decided to focus on the auto industry first?

Mr. MCRAITH. We, by statute, are required to monitor the affordability and accessibility of non-health insurance to traditionally underserved communities.

Ms. MOORE. And just very quickly—

Mr. MCRAITH. We chose auto because studies show auto insurance and automobile ownership enable lower-income people to commute to jobs that they need.

Ms. MOORE. Exactly, exactly. We don't want to cut off those—that credit to low-income people, already low-income people are suffering tremendously from the pendulum swing of financial services being available to them. Thank you. Thank you, Mr. Chairman, for your indulgence.

Chairman LUETKEMEYER. The gentlelady's time has expired. With that, we go to the gentleman from California, Mr. Royce. He is recognized for 5 minutes.

Mr. ROYCE. Thank you very much, Mr. Chairman.

Director Huff, I will just go back to some of your testimony. You mentioned that 32 jurisdictions have now passed legislation implementing the NAIC model reinsurance collateral law. But the reality is that 4 years is a long time, and we are still at a point where major States like Texas and Illinois are not part of that.

And so, I was wondering if you say that we need to avoid the variation between the States by reducing collateral requirements in a consistent manner, it looks to me like, by your own test, we are not close to implementing this. And the presumption I would have had was that the pressure that would have been applied by the threat of a covered agreement might have brought everybody to the table.

The worry I have is that since 1871, we have been trying to get the States to adopt a common framework. Give me your thoughts on why you think this is going to be done in a timely way, and stave off the problems that I anticipate here?

Mr. HUFF. So on the topic of credit for reinsurance revisions that have taken place, the process has been deliberate. It has been very methodical; it is very measured and transparent in the way we are reducing collateral for foreign reinsurers. We have had 32 States, that is about two-thirds of the U.S. market, about 66 percent of the U.S. market in terms of premium. We have five other States that are seriously considering it and are ramping it up for their legislatures to consider, which will take us over 90 percent, to about 93 percent of the market.

Mr. ROYCE. If you can get there. By way of example, if we went back through testimony in the past in terms of how many times we thought we were a year away from achieving this goal from 1871 on, in terms of reaching unanimity, it hasn't happened yet. Now 4 years may not seem like a long frame by that standard, or certainly by congressional standards, to be fair here, but I am highly skeptical that you are going to bring States into line based upon what I have seen in past performance here with respect to getting this unanimity.

Mr. HUFF. Well, Congressman, I would point to the fact that we have yet to have the decision whether we would make the credit for reinsurance provision an accreditation standard. So I will give you the example that we just went through from the model holding company act, a model that we developed in 2010 to allow insurance regulators access to the information from the holding company. That model was developed in 2010, is an accreditation standard as of 1/1/16, and we plan to have all 50 States, plus D.C., having adopted that model. So as we in November start the conversation—

Mr. ROYCE. I understand.

Mr. HUFF. —about accreditation for reinsurance. That is a hammer we have, is my point.

Mr. ROYCE. Okay. Director McRaith, as you know, I am going to share this with you today, I sent a letter to the Treasury Secretary and the USTR calling for a covered agreement with the EU. Based on your diligent work on this issue, I assume you agree such an agreement is a positive tool that the United States should use in attempting to tackle reinsurance collateral and make progress on the question of U.S. regulatory equivalency?

Mr. MCRAITH. That is exactly right, Congressman. What we know is that effective January 1, 2016, the European Union, which is the largest consolidated market in the world, will be subjecting U.S. insurers to regulatory standards that differ from those applied to insurers domiciled in some other jurisdictions. A covered agreement will provide clarity, finality, and certainty for U.S. insurers that either are now or seek to operate in the European Union market.

Mr. ROYCE. Let me jump in on another topic. On January 27th, the Homeland Security chairman, Mike McCaul, and I sent an unanswered letter to the President asking how the Administration classifies and defines different types of cyber attacks. Specifically, we asked whether the use of different terms like cyber warfare, cyber vandalism, or cyber terrorism would impact the Treasury Secretary's authority to certify a cyber attack as an act of terrorism under TRIA.

So I assume this is a question you have contemplated as part of a larger question. And I think a clear statement from Treasury on what is and is not covered under TRIA as it relates to cyberterrorism would increase certainty in the market and help encourage individual capacity for cyber insurance. Can you help make that happen?

Mr. MCRAITH. I absolutely appreciate that perspective. The statute does not specify what are the causes or types of terrorist attacks. In 2007, when I testified as a State regulator in support of renewal of TRIA, nobody talked about cyber. So the fact it is not specifically listed does not mean it is not included. If an event, a cyber event or any type of event, satisfies the statutory criteria, then it is eligible for TRIA certification.

Mr. ROYCE. Thank you, Director McRaith.

Chairman LUETKEMEYER. The gentleman's time has expired.

I will now go to the very patient gentleman from Michigan, Mr. Kildee.

Mr. KILDEE. Thank you, Mr. Chairman. And I thank the witnesses for your testimony. I do want to follow up very briefly on the question that Ms. Moore raised right at the very end. So if I could start with Mr. McRaith, and I appreciate your work and your willingness to confer with me in the past on issues important to the industry, but I want to follow up. When Ms. Moore asked why FIO determined to make auto insurance the focus of your first steps towards implementing the specific responsibility regarding affordability and access, you indicated, I think appropriately, that often it is the barrier, perhaps of transportation access to affordable transportation that could stand in the way of an individual living in an impoverished community from access to economic opportunity.

I don't want to put words in your mouth, but implicit in that is that there may not be available, affordable insurance to some of those populations. I wonder if you would just perhaps elucidate a bit more on what would cause you to conclude that—and I don't want to disagree with the conclusion; don't get me wrong—is a problem that needs to be addressed. If you could just touch on that.

And I would actually, Mr. Huff, perhaps because some of the communities within your State, you might make the same observation.

Mr. MCRAITH. You are absolutely right in the sense that transportation and personal vehicles allow people to have more than one job, to deal with children. Often people don't own a home but do have a car because they need it to survive. We know that.

Now, whether there is an issue with affordability and accessibility is an issue debated within the insurance sector. Some people would say no because the residual markets are very sparsely populated. Others would say yes because there is a relatively high percentage of uninsured in urban areas.

What we are trying to do, Congressman, is establish a standard to answer that question exactly and precisely for you.

Mr. KILDEE. But do you, just based on your experience in Illinois, for example—and, Mr. Huff, in Missouri—and I know anecdotes are often difficult to extrapolate to a larger trend, but is it safe to say that it is certainly the case in older, particularly impoverished communities, that the cost of insurance is often beyond the reach of many of the individuals because the premiums are much greater in those communities than they might be in a neighboring community with fewer challenges?

Mr. MCRAITH. That is a fair statement, and certainly the State of Michigan, we know, has some issues and challenges with the personal auto market, and I think your statement, broadly speaking, is true.

Mr. KILDEE. Mr. Huff?

Mr. HUFF. So NAIC does have an auto insurance study group, and they have already been conducting some of their own analysis related to low-income households and the auto insurance marketplace, and we issued a report last year that included some consumer and industry perspectives as well as an overview of State programs and initiatives to address these affordability and availability issues.

I will tell you in my State, we collect data not only for auto, but also for homeowners at a ZIP Code level. And that is very important because then you are able to work through any issues, and identify if there are any issues in certain ZIP Codes that may require action by the regulator.

You may have missed my opening comments or comments that I made to Congressman Cleaver's question. Right now, Missouri has a very competitive auto market. We have just been named the seventh most competitive in the country, so our auto industry, we have about 175 carriers actively writing business. And as you noted, or Director McRaith noted, our residual market has almost no participants. So we are in pretty good shape on the auto side in my State, but I am very sensitive to these areas—issues in other States as well.

Mr. KILDEE. Starting with Mr. McRaith, could you address the tools that a State insurance commissioner might have available to them or statutory approaches at the State level? Assuming that there would be some disparity that is not going to be overcome by just increased awareness, what tools would a State commissioner have available to deal with significant disparity, lack of access to insurance, auto insurance in particular?

Mr. MCRAITH. The regulatory tools vary from State to State. The cost drivers vary from State to State. Generally speaking, I think Director Huff made an excellent initial point, which is that information is essential. Presently, Missouri collects information, and a couple of other States do, but by and large, detailed information about personal auto market and costs on a ZIP Code basis is not collected. So information is the first tool that a regulator has. And then in other States, there are regulatory mechanisms where the State regulators can evaluate the rate proposed by the firm and then decide whether to approve or disapprove that. But, again, it depends on the State. In the State of Illinois, for example, we did not have rate approval, and frankly, in many cases and in most parts of the State, that worked just fine for us.

Mr. KILDEE. Thank you. Thank you for your testimony.

And thank you, Mr. Chairman, for your indulgence.

Chairman LUETKEMEYER. The gentleman from Michigan's time has expired.

With that, we recognize the gentleman from Ohio, Mr. Stivers, for 5 minutes.

Mr. STIVERS. Thank you, Mr. Chairman.

Thank you for this very important hearing. My first question is for Director McRaith and Mr. Sullivan. So the IAIS is issuing its first version of the high loss absorbency rule, which is a capital surcharge on nine of the world's largest insurers, three of which are headquartered in the United States, and the IAIS is about to at the same time launch consultations to revise two of the important components of HLA: first, the definition of nontraditional insurance; and second, the assessment criteria used to designate systemic insurers. I am curious if you think that we need to maybe change those two critical elements of the formula before finalizing the capital surcharge, which is largely based on those two components?

Mr. MCRAITH. You are absolutely correct. The HLA that is developed this year, and I mentioned this earlier, is just the initial version, the initial iteration. It is subject to change because many of the components are in flux. The document itself when it is publicly released, which will be soon, will explicitly state it is subject to change depending upon revisions to NTNI and the G-SII methodology. So your point is exactly right, and the United States. participants at the IAIS strongly supported and endorsed that concept.

Mr. STIVERS. Great. I would like to move on to Director McRaith. Mr. Sullivan, did you have anything to add to that?

Mr. SULLIVAN. I would associate myself with all those comments.

Mr. STIVERS. Great. I do want to move on, Director McRaith, to something the gentleman from Michigan was just talking about. With regard to your study on underserved communities and the affordability of insurance products, especially auto insurance, I am curious how you chose to define, and why did you choose that definition of affordable? You can be very brief on that.

Mr. MCRAITH. We have not settled on a definition of affordable. We have now offered two Federal Register proposals and received comment. We are working to get to the best approach, recognizing that it is not going to satisfy everybody.

Mr. STIVERS. I appreciate that, and I will tell you I am very concerned about a very big data call like this where there is a lot of publicly available data. If you would choose a definition of affordability based on consumer spending, you would get a lot of opportunity to use Bureau of Labor Statistics data. If you would go another direction, you could get a lot of NAIC data. I just feel like it is really important for you to use publicly available data first before you have a very large and burdensome data call. Can you comment on your thought process with regard to that?

Mr. MCRAITH. One of the questions that we ask in both of our Federal Register notices is what are the best sources of data and information. We completely agree with you. Publicly available data is best. We have no desire, no objective, to initiate some data call. We want to obtain information that satisfies the statutory mandate, but we do not want to increase the burden on industry participants. We certainly do not want to increase the burden on our limited resources. We do have to meet the mandate of the statute, and we are going to do that in an effective and efficient way.

Mr. STIVERS. Thank you. I appreciate that. And I appreciate the efficient and effective part of it, and obviously, efficient is part of efficient and effective, so please do your best on that.

The next question I have is for Commissioner Huff. With regard to your regulatory jurisdiction, you have a lot of jurisdiction in your State over the regulation of annuities, and I am curious if anyone at the Department of Labor has talked to you about their new rule with regard to fiduciary duty and input they have gotten from you or what they have sought from you?

Mr. HUFF. Yes, thank you. So we do appreciate the Department of Labor's intent to protect consumers as they make important decisions to provide for their retirement security. We were a bit dismayed that we were not contacted before the rule was put out by the Department of Labor, but we have since been contacted as State insurance regulators through the NAIC. We have engaged with the Department of Labor and the Administration since the proposed rule was released in the spring. There are obviously some issues with the rule on clarity, and there is quite a bit of regulatory uncertainty in what is in the rule today, and we have expressed those concerns to the Department of Labor.

Mr. STIVERS. I appreciate that, and I hope they will reach out to you, the SEC, FINRA, the Treasury, and the IRS. There are a whole bunch of people in this space, and it seems like the Department of Labor has not been very coordinated or information-seeking in their efforts. Thank you.

I yield back, Mr. Chairman.

Chairman LUETKEMEYER. The gentleman's time has expired.

We go to the gentleman from Minnesota, Mr. Ellison, for 5 minutes.

Mr. ELLISON. Thank you, Mr. Chairman, and I also thank the ranking member.

Director McRaith, I want to thank you and your team for the 2015 annual report. Good job. American families need and value quality and affordable insurance to enable their financial stability. And I wanted to ask you about a couple of things in the report. Last year's report did not mention title insurance, and I am happy to see that this year's report does mention title insurance. And I have asked for a quote from Treasury's annual insurance report to be shown on the screen, which you can probably recognize up there. I guess my question is, could you describe for me how your team feels about the present state of affairs regarding reverse competition and kickbacks in the realty industry?

Mr. MCRAITH. Congressman, I think our report speaks for itself in the sense that it is an issue in the insurance sector. It is something that several States have expressed concern about. We think State regulators, the States should be looking at this closely. We look to monitor and assess those developments as we move forward.

Mr. ELLISON. Thanks a lot. In your view, is it unusual in the insurance world for a referral source to receive compensation either at a lower desk rents, tickets to special events, or shared ownership in other insurance products? Is that unusual?

Mr. MCRAITH. I hesitate to comment on what is typical or usual or unusual other than to say, clearly, in some cases, those practices were abusive, and law enforcement and others looked at them very closely.

Mr. ELLISON. Would strict liability in this industry, that is requiring underwriters to have equal financial liability for all of the actions of agents ensure that home buyers get services in their own best interests?

Mr. MCRAITH. Forgive me for not wanting to offer a view on the question of strict liability or appropriate causes of action, but I think we are focused on the issues with insurance and look to support this committee and your interest in this subject.

Mr. ELLISON. Thank you for your hard work.

Mr. Huff, I have a question for you, sir. Why should a referral source receive a financial benefit for the referral? Why should a REALTOR®, mortgage broker or builder benefit from referring a home buyer to a title insurance agent?

Mr. HUFF. That is an area we are exploring very heavily. I know you have spoken to my colleague, Minnesota Insurance Commissioner Mike Rothman. He is very interested in this issue. We have established our NAIC title insurance task force. They continue to discuss the issue of affiliated title insurers and ways to avoid conflicted referral advice from entities we regulate that play a role in a home purchase transaction, which, as you know, for many people, that is the biggest transaction of their lives.

So we have reached out to stakeholders. The task force is meeting, collecting comments from regulators. And we will discuss this further at our fall national meeting, which is being held in Maryland this year. So, in fact, I think we have reached out to your staff to invite them to hear what is going on in that task force. So this is an issue that is receiving regulatory attention.

Mr. ELLISON. I appreciate it, and I want to say thank you to you as well. I wonder if you might comment on the National Association of Insurance Commissioners and what they are doing to ensure home buyers are not harmed by reverse competition and conflicted referrals?

Mr. HUFF. Through this task force, that is sort of the starting point, if you will, for insurance regulators to come together, and then they will make a decision at that task force whether there is action required. And then there are a variety of ways to do that. We can go through a model law, if you will, or a model regulation and then decide how that is teed up for the States to consider at adoption.

Mr. ELLISON. I want to say thank you for your work. I have a bill, Ensure Fair Practices in Title Insurance, H.R. 1799, and my bill prohibits the financial benefit for a referral. So I would welcome your input, and I just want to say thank you to the panel.

And I will I yield back my 25 remaining seconds to the Chair.

Chairman LUETKEMEYER. I thank the gentleman for yielding.

I would like to thank the witnesses for their testimony today. You guys have been great, fantastic, as a matter of fact.

I know I mentioned a while ago that one of the important aspects of this committee is oversight. I know in talking to Mr. Sullivan and Mr. McRaith that they made comments to me that our oversight, the willingness of us to delve into issues and to support them and to push for certain protections for our insurance industry gives them the ability to push back at the international level in their discussions. So I think it is important that we continue to make that point to them that we are here to push back or help them push back. And we are here to protect the domestic insurance companies and want to work with them with regard to international capital standards as well.

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 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

And with that, this hearing is adjourned.

[Whereupon, at 3:55 p.m., the hearing was adjourned.]

A P P E N D I X

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Testimony of

John M. Huff

Director

Missouri Department of Insurance, Financial Institutions, and Professional Registration

On Behalf of the National Association of Insurance Commissioners

Before the

Subcommittee on Housing and Insurance

Committee on Financial Services

United States House of Representatives

Regarding:

Domestic Insurance Regulatory Issues

Introductory Remarks
Chairman Luetkemeyer, Ranking Member Cleaver, and members of the Subcommittee, thank you for the invitation to testify today. My name is John Huff, and I am the Director of the Department of Insurance, Financial Institutions, and Professional Registration for the State of Missouri. I am also President-Elect of the National Association of Insurance Commissioners (NAIC)[1] and serve as the Chair of the NAIC's Financial Regulation Standards and Accreditation (F) Committee, its Reinsurance (E) Task Force, and its Governance Review (EX) Task Force. From 2010 to 2014, I served as the state insurance regulator representative on the Financial Stability Oversight Council (FSOC). On behalf of my Department, my fellow state insurance regulators, and the NAIC, I appreciate the opportunity to testify today. I look forward to discussing the ongoing work of state insurance regulators and the NAIC as well as our views on several topics of interest to members of this subcommittee and insurance sector stakeholders.

Mr. Chairman, I especially want to thank you for participating in our NAIC Commissioner Fly-In earlier this year – your remarks were extremely well received and a great way to kick off two days of meetings with members of the administration and our Congressional delegations. I also want to recognize the Ranking Member, Congressman Cleaver, another fellow Missourian. As you know, your district is home to the NAIC's central office and we appreciate your continuing support of our organization and state insurance regulation.

State insurance regulators supervise nearly a third of all global premium – more than $1.8 trillion. Taken individually, U.S. states make up more than 24 of the world's 50 largest insurance markets, including my home state of Missouri. The insurance market in Missouri represents $33 billion in direct written premium in an industry that employs approximately 45,000 people statewide.

State regulators share a mission of ensuring a stable, competitive, and well-regulated marketplace where U.S. consumers are well-informed and well-protected. We cooperate closely on a regular basis, and we have long been committed to providing leadership across the entire spectrum of global and domestic insurance issues and activities. While today's hearing is focused on domestic insurance regulation, it is important to note that the NAIC is hard at work on critical regulatory issues at all levels, and efforts at home often dovetail with our international priorities. As insurance markets grow and become ever more complex and sophisticated, our regulatory tools and priorities must also continually evolve, both at home and abroad. With that, allow me to update you on just a few of the long-standing and new initiatives state regulators are working on through the open and transparent NAIC process.

[1] Founded in 1871, the NAIC is the U.S. standard-setting and regulatory support organization created and governed by the chief insurance regulators from the 50 states, the District of Columbia and the five U.S. territories. Through the NAIC, state insurance regulators establish standards and best practices, conduct peer review, and coordinate their regulatory oversight. NAIC members, together with the central resources of the NAIC, form the national system of state-based insurance regulation in the U.S.

Holding Company Model Act & Group Analysis

The 2008 financial crisis illustrated the need for financial regulators to see into the dark corners of a firm to ensure all risks are known and understood and that consumers that could be negatively impacted by those risks, directly or indirectly, are protected. Even if a regulator has broad powers to protect consumers by walling off their funds from risks elsewhere in a firm, as state regulators do with insurers, it is important to understand those other risks that can create credit, reputational, and other problems. With this in mind, state regulators undertook a public process to make significant advances to the NAIC's Model Holding Company Act.[2] This model act, which is a part of every state's insurance code, provides state insurance regulators the ability to regulate transactions and interactions between insurance companies and other entities within the wider holding company system, up to and including the ultimate controlling person. State insurance regulators revised the model law in 2010 to enshrine a "windows and walls" approach to insurance holding system regulation, whereby regulators can erect the walls necessary to protect policyholders and restrict assets from leaving the legal entity insurers, and peer through windows that allow a view into the activities, including non-insurance activities, throughout the wider group.

Specifically, the revisions to the model act provide additional authority with respect to transactions that directly and indirectly affect the legal entity insurer. The ultimate controlling person is required to submit an enterprise risk report to the lead state insurance regulator of the insurance group. State insurance regulators have authority to require the filing of financial statements relating to the insurance holding company system upon request. The law expanded the range of transactions between an insurer and its affiliates subject to prior approval by the insurance regulator. Examination authority can be exercised over <u>any</u> entity within an insurance holding company system to ascertain the financial condition of the insurer as well as the enterprise risk to the insurer through activities elsewhere in the holding company system. This authority includes access to books and records, issuing subpoenas and compelling production of information. Recognizing the global environment in which large insurance companies and financial conglomerates operate, the model act authorizes the commissioner to participate in, and even lead, supervisory colleges among regulators across jurisdictions. Further updates in 2014 provide explicit authority for the commissioner to act as the group-wide supervisor of an internationally active insurance group. Most of these enhancements become NAIC Accreditation requirements as of January 1, 2016 – in anticipation of that, all but one state have already adopted them.

Closely related to our efforts to better supervise holding companies is updating the way we conduct group analysis. The NAIC recently adopted group analysis procedures to establish consistency in the types of reviews performed for insurance holding company systems and the documentation of the results. We also adopted the Risk Management and Own Risk and

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[2] *Insurance Holding Company System Regulatory Model Act* (NAIC Model #440).

Solvency Assessment (ORSA) Model Act[3] in 2012, which includes the ORSA Summary Report filing requirement. An ORSA filing provides an enterprise-wide, detailed description of the entity's risk management system, an identification of its key risks in normal and stressed environments, an assessment of its capital adequacy for the risks in normal and stressed environments, and identification of prospective risks. Thirty-four states[4] have already adopted the related model law (which will become an NAIC Accreditation requirement in 2018) requiring ORSA filings, and this year most of these states will begin receiving such filings. As we continue our progress developing group supervisory tools and processes, the NAIC is also beginning discussions regarding a potential group capital calculation as part of our U.S. group supervision model.

Principle-Based Reserving

Another long-standing project for the NAIC is the implementation of Principle-Based Reserving (PBR). PBR is a fundamental change to the life insurance sector that is a result of years of thoughtful debate and deliberation. PBR replaces a more formulaic method for determining life insurance policy reserves with an approach that more closely reflects the risks of highly complex products. The improved calculation is designed to "right-size" reserves, reducing reserves that are too high for some products and increasing reserves that are too low for others. This new method will help reduce the incentive for company workarounds of reserve requirements. Importantly, though, this new approach doesn't eschew the formulaic approach entirely—it includes the guardrails of minimum reserving requirements, while allowing reserving methodologies to reflect the heterogeneity of various life insurance products.

PBR includes two changes of law and a new Valuation Manual. The NAIC adopted the revised Standard Valuation Law (SVL) in 2009, the revised Standard Nonforfeiture Law in 2012, and the revised Valuation Manual in 2015. We currently have thirty-six states[5], accounting for roughly 60% of the market that have adopted the SVL. Six additional states have introduced or plan to introduce PBR legislation in 2015, and represent an additional 17.2% of premium. Once at least 42 states comprising at least 75% of total U.S. premium adopt the revisions to the SVL, PBR will become operative and will be phased in over the following three years. Based on state expectations of legislative activity, PBR could be in place as early as 2017. We continue to update the data tables and other parts of the Valuation Manual as will be needed for implementation.

[3] *Risk Management and Own Risk and Solvency Assessment Model Act* (NAIC Model #505).
[4] AK, AR, CA, CT, DE, GA, IA, IL, IN, KS, KY, LA, ME, MN, MO, MT, ND, NE,NH, NJ, NY, NV, OH, OK, OR, PA, RI, TN, TX, VA, VT, WA, WI, and WY.
[5] AR, AZ, CT, CO, DE, FL, GA, HI, IA, IL, IN, KS. KY, LA, MD, ME, MI, MO, MS, MT, ND, NE, NH, NJ, NM, NV, OH, OK, OR, RI, SD, TN, TX, VA, VT and WV. The CA and NC legislatures have adopted SVL and the Standard Nonforfeiture Law, which await the Governors' signatures.

In addition to the Valuation Manual updates the NAIC is developing a regulatory review system to ensure effective and consistent implementation of the PBR framework. This includes the creation of a new Valuation Analysis Working Group that will help us ensure compliance with the Valuation Manual and consistent industry treatment. This group, comprised of top valuation experts from state insurance departments, will evaluate the companies' PBR valuation and work with state regulators to ensure quality oversight.

We are still analyzing state and NAIC resource needs as we implement this project. The NAIC has hired a team of three life actuaries to help build the actuarial review process for PBR and determine what systems can be built to aid the states on an on-going basis. Once the regulatory review process is built, we plan to conduct a PBR pilot, much like what we did with the ORSA. This will help us identify any changes needed to regulatory requirements or the review process and help companies implement PBR. We also plan to develop a series of new training courses and programs for regulators as they prepare to implement these fundamental changes to reserving requirements.

Captive Reinsurance Transactions

Closely related to our shift to PBR are state regulators' efforts on the use of captive reinsurance by the life insurance industry. Historically, captive insurers have been used by a variety of businesses to self-insure risks and therefore are subject to different regulatory requirements designed to protect a single sophisticated policyholder rather than multiple retail insurance consumers. However, captive use has expanded in recent years and now includes life insurer-owned captives which reinsure policies written and sold by traditional life insurance companies. In particular, life insurers have increasingly used captives to finance the reserve "redundancies" associated with requirements for universal life products with secondary guarantees features and term life insurance. The captive regulation that makes sense in the context of a commercial business self-insuring its own risks creates concerns for state insurance regulators regarding transparency and consistency when applied to individual policyholder risks backed by life insurance companies.

To address these concerns, the NAIC began studying the use of captive reinsurance by life insurers in 2012, culminating in a white paper adopted by the NAIC in 2013.[6] That study found that by far the largest use of captive reinsurance by life insurers was to address the excessive policy reserve standards required by state law, relating to universal life insurance policies. So, we undertook reforms to establish standards to ensure strong solvency protection and to achieve greater consistency and transparency for those transactions. In August 2014, the NAIC adopted a comprehensive Reinsurance Framework such that a life insurer will be allowed to take financial credit for the reinsurance transaction with its captive only if certain financial criteria are met. A

[6] *Captives and Special Purpose Vehicles: An NAIC White Paper,* July, 2013. Available at http://www.naic.org/store/free/SPV-OP-13-ELS.pdf

consistent reserving method has been developed and adopted by the NAIC as Actuarial Guideline 48 (AG48) and was effective 1/1/15 on all new policies issued. Our permanent solution to greatly reduce any incentive to use captives for reserving purposes is PBR, discussed previously, which will move us away from our current formulaic process (a one size fits all) to "right size" reserves to risks and policyholder experience. In the meantime, AG48 requires the actuary for the life insurer to issue a qualified actuarial opinion if and when the NAIC's framework is not followed. This type of opinion would obviously lead to heightened scrutiny of the company's solvency.

Additionally, a new public disclosure was required as of April 1, 2015, for all life insurers reinsuring this type of business to a captive. This disclosure now provides transparency to the reserves and assets held in the captive, which had typically been included in confidential captive financial statements. The NAIC *Financial Analysis Handbook* was also modified to include detailed procedures for analyzing these captive reinsurance transactions, which must be followed according to the NAIC Accreditation program. This Accreditation program, which I currently chair, helps ensure consistency in solvency standards across the country.[7] To that end, we recently adopted changes so that if a captive reinsurance transaction does not comply with the Regulatory Framework identified above, the captive will essentially be treated as a traditional third party reinsurer and subject to all related laws, regulation, and oversight. The NAIC is also examining other more limited use of captives by life insurers as a means of hedging the risk associated with variable annuity contract guarantees – we are already acting to develop a regulatory response plan, which could be adopted by the end of this year. Finally, while there has been very limited use of life insurer-owned captives to reinsure long-term care products, we are in the process of analyzing these few transaction to help determine our next steps.

Cybersecurity / Data Breach Legislation

Another top priority for the NAIC is Cybersecurity. Cyberattacks have the potential for devastating results for companies, consumers and the financial system at large. As data breaches become more common, we know the potential privacy implications are tremendous for consumers and the costs for companies can be substantial. State regulators take very seriously our responsibility to ensure the entities we regulate are adequately protecting the many kinds of highly sensitive consumer financial and health information they retain. We understand that Cybersecurity is a CEO and Enterprise Risk Management issue, not just an IT issue. Where criminal activity has taken place, we work closely with state and federal law enforcement agencies.

Earlier this month, Deputy Secretary of the U.S. Treasury Sarah Bloom Raskin observed that "state insurance regulators are the cops on the beat when it comes to cybersecurity at insurance

[7] All 50 states, the District of Columbia, and Puerto Rico are currently accredited. For more information on the Accreditation program, see http://www.naic.org/committees_f.htm

companies and the protection of sensitive information of applicants and policyholders."[8] Recent high profile data breaches at large health insurers have illustrated that role. For example, since the Anthem and Premera breaches were announced, state regulators have worked with the companies, the FBI, and the cybersecurity firms they retained to evaluate the attacks, repair their systems, and prevent future attacks. The companies have sent notices to customers and set up websites and toll-free hotlines to answer affected consumers' questions. Both companies are providing free credit monitoring and identity protection services to affected policyholders and applicants. In the immediate wake of the announcements, regulators held daily discussions with company executives to ensure appropriate steps were taken to protect insurance consumers whose data may have been compromised. NAIC members issued a nationwide consumer alert and promptly started coordinated multi-state examinations; both exams are ongoing.[9]

In addition to our work addressing the concerns surrounding specific breaches, we also have been addressing cybersecurity related issues through our Cybersecurity Task Force, which was established last year. I serve on this task force, which is responsible for the coordination of our efforts on a number of fronts: the protection of information housed in insurance departments and the NAIC; the supervision of insurers' efforts to protect customer information that they collect; and the monitoring and regulation of companies writing ever more complex and specialized cyber-liability policies.

To that end, our task force has had a very busy year. After extensive comments from the insurance industry and consumer groups, we adopted our twelve *Principles for Effective Cybersecurity: Insurance Regulatory Guidance*. The principles set forth the framework through which regulators will evaluate efforts by insurers, producers, and other regulated entities to protect consumer information. We also developed the *Cybersecurity and Identity Theft Coverage Supplement* for insurer financial statements to gather financial performance information about insurers writing cyber-liability coverage nationwide.

In addition, the NAIC is updating our Financial Examiner and Market Regulation Handbooks, used by regulators across the country. These handbooks provide guidance for on-site examiners assessing insurers' information controls and measures taken to protect the security, confidentiality, and integrity of policyholder information. The task force is also developing a *Cybersecurity Consumer Bill of Rights* for insurance policyholders whose data has been breached, as well as conducting a review of all existing protocols, model laws, and regulations regarding data security for insurers.

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[8] CSIS/NAIC Forum: "Managing Cyber Risk and the Role of Insurance," September 10, 2015. Remarks available at: http://www.treasury.gov/press-center/press-releases/Pages/jl0158.aspx

[9] Missouri is one of seven lead states conducting the Anthem multi-state exam. One in three Missourians was potentially affected by the data breach.

Recognizing that cybersecurity and associated regulatory concerns stretch far beyond the insurance ecosystem, we are working with other financial regulators, Congress and the Administration to identify specific threats and develop strategies to protect the financial infrastructure of this country. We are active members of the Treasury Department's Financial Banking and Information Infrastructure Committee (FBIIC) and the White House's Regulatory Cybersecurity Forum for Independent and Executive Branch Regulators, where we work with our federal colleagues across all sectors of the economy to share best practices and discuss lessons learned in tackling this difficult issue.

Cybersecurity also presents a unique opportunity for the insurance sector to innovate, drive best practices, and help businesses of all kinds protect against the risk of cyber losses. As insurers develop standards and tools for underwriting in this organically growing market, regulators are committed to keeping pace with technological and market developments to provide regulatory certainty and predictability for insurers and policyholders.

We are aware that Congress has once again taken a strong interest in potential data breach legislation. While we understand and appreciate the potential benefits of establishing common definitions and cross-sector minimum standards for data security, we remain skeptical of any efforts that involve unnecessarily broad preemption of state authorities to require safeguarding of consumer information or mitigation of harm caused by data breaches to insurance consumers. States must remain free to go above and beyond standards recommended or required by federal law. While well intentioned, such preemption may actually undermine existing consumer protections, as well as inhibit future enhancements and innovation necessary for regulators and companies to adapt to evolving threats.

Ultimately, any Congressional activity on cybersecurity should not disregard the existing state insurance regulatory framework and should not inhibit ongoing efforts in the states to develop laws and regulations in the best interests of insurance consumers.

Reinsurance Collateral / Covered Agreement

Another area of significant activity for state regulators is the measured and transparent reduction of collateral requirements for foreign reinsurance transactions. Historically, when a U.S. insurance company was ceding some of its risk to a foreign reinsurance company, state regulators required that foreign reinsurer to hold 100% collateral onshore in the U.S. to ensure rapid payment to the insurers, and ultimately to policyholders. As an example, a significant portion of the hurricane risk taken on by U.S. insurers is now spread globally when those insurers purchase reinsurance. That's a good thing for the market, but it means that if a large disaster occurs, U.S. insurers need those reinsurers to transfer huge amounts of money to quickly repay policyholders. Over time, foreign reinsurers, regulators, and politicians have objected to collateral requirements, arguing they trap capital and are inefficient. In response to these objections, state regulators embarked on an effort to reduce collateral if the reinsurer is in solid financial health and is overseen by an effective regulator in its home country.

Specifically, the NAIC adopted revisions to our Credit for Reinsurance Model Law in November 2011, allowing reduction of the 100% collateral requirement for certified reinsurers regulated by qualified jurisdictions.[10] As of today, 32 states have adopted the revisions representing more than 66% of direct insurance premium written in the U.S. across all lines of business. We are also currently aware of 5 additional states that are actively considering the model or similar proposals which would raise this market share to approximately 93%. The NAIC has also established a peer review system surrounding the certification of foreign reinsurers by states, which provides a foreign reinsurer an opportunity for a passport[11] throughout the U.S. As of September 1, 2015, the NAIC has approved seven jurisdictions as qualified jurisdictions, and 28 certified reinsurers have been approved through the NAIC's Reinsurance Financial Analysis Working Group review process.[12]

We believe this is an excellent example of states responding quickly to global market developments while preserving our focus on U.S. policyholder protection. We are charged with the protection of U.S. insurance policyholders, and thus it is both our responsibility and our obligation to determine the appropriate reinsurance collateral rules and levels to ensure insurance consumers are protected.

Covered Agreement

In spite of extensive state responsiveness and action on reinsurance collateral, we understand that the Treasury Department and the United States Trade Representative (USTR) are preparing to start negotiations on a covered agreement with the EU to address reinsurance collateral and to resolve uncertainty for U.S. insurers as a result of the EU's equivalence process under its new solvency regime, Solvency II.[13] This federal action could unnecessarily preempt state laws and progress on reinsurance reforms and the Treasury and USTR have simply not demonstrated benefits to U.S. insurers or consumers that would warrant the need for entering a covered agreement preempting state law.

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[10] Determinations are made by the NAIC Qualified Jurisdiction (E) Working Group.

[11] "Passporting" refers to the process under which a state has the discretion to defer to the certification of a reinsurer and the rating assigned to that certified reinsurer by another state.

[12] As of January 1, 2015, Bermuda, France, Germany, Ireland, Japan, Switzerland, and the United Kingdom are qualified jurisdictions.

[13] The authority to pursue a covered agreement was included in the Dodd-Frank Act as a unique stand-by authority to address, if necessary, those areas where U.S. laws might treat non-U.S. insurers differently than U.S. insurers, such as reinsurance collateral requirements. USTR and Treasury must consult with Congress and submit any proposed agreement to the House ways and Means, House Financial Services, Senate Banking, and Senate Finance Committees for a 90 day review period before it can become effective.

With respect to equivalence, the EU plans to start enforcing its new Solvency II regime in January 2016, although some aspects will be phased in over the next 16 years. The Solvency II directive provides for the EU to make an equivalence determination for third countries in the areas of group supervision, group solvency, and reinsurance. All of these equivalence determinations require that an appropriate confidentiality regime be in place. Non-EU-based companies from countries that have been deemed equivalent may be subject to less regulatory duplication to operate in the European Union than those jurisdictions that have not been deemed equivalent. Importantly, EU companies do significantly more business in the U.S. than U.S. companies do in the EU and many, if not all, EU subsidiaries of U.S. companies are already structured in a way to meet the new European requirements in the absence of equivalence. We have long contended that although our regulatory system is structured differently than Europe's, it results in similar outcomes, and should not be a basis for imposing duplicative regulation on U.S. insurers operating abroad. We question whether a covered agreement, or any formal action by the federal government, is necessary to resolve equivalence as it is clear that recognition can be achieved through other mechanisms such as recognition of existing structures and processes. In fact, the European Commission has already deemed the U.S. system of group solvency and confidentiality equivalent without the need for a covered agreement or any federal action.

Before the federal government begins negotiating directly with a foreign government on an agreement that pertains directly to, and could preempt, insurance prudential standards primarily developed, implemented, and enforced by the states, we expect a clear and compelling case to be made for such drastic action. No such case has been made. And, should Treasury and USTR move forward regardless of the lack of justification, state regulators should be at the table directly involved in any discussions or negotiations to ensure our regulatory system is not compromised.

SIFI Designations / Exit-Ramp

In September of 2010, I was selected by my fellow state regulators to serve on the FSOC as the state regulators' non-voting representative. This was a tremendous honor and one that gave me important perspective on the risks facing our financial system. Let me be very clear, I believe in the important role that FSOC plays in our financial regulatory system. By bringing together regulators from the different financial sectors, banking, insurance, and market regulation, each with different perspectives and expertise, the FSOC can be a robust vehicle for monitoring risks facing our financial system. However, today it is flawed. To date, FSOC has voted to designate two insurance companies Systemically Important Financial Institutions (SIFI's): Prudential and Metlife, both over the objections of the independent member with insurance expertise and the state insurance regulator representative. In the case of Prudential, I issued a dissenting statement because I believed FSOC's rationale for designation to be flawed, insufficient, and unsupportable.[14]

[14] *View of Director John Huff, State Insurance Commissioner Representative.* July, 19, 2014. Available at: http://www.naic.org/documents/index_fsoc_130920_huff_dissent_prudential.pdf

In neither of these two insurer cases did the FSOC justify the designation by identifying specific activities of the company that could have a systemic impact on the United States' financial system or specific actions required to reduce the risk to the system. In other words, today, according to FSOC, there are companies that potentially threaten our financial system, yet neither the company nor their primary regulators know which risks to address. FSOC is statutorily required to review designated firms on an annual basis, but even that process has failed to yield any specific information for regulators or companies as to the nature of risks to be mitigated or actions that would result in rescinding a designation.

Frankly, this is unacceptable. Regulators should be given the insights necessary to actively work to de-risk designated firms. Failure to require a clear rationale as to the reasons for designation and to provide an "exit ramp" for designated firms is a fundamental flaw with the nonbank designation process. It **contributes to rather than reduces risk to the financial system** by lulling policymakers into a false sense of security that Fed supervision and enhanced prudential standards such as SIFI capital surcharges will reduce the risks designated firms pose to the system. If there is any lesson from the financial crisis, it is that capital alone will not save us. Additional capital would not have prevented the potential systemic impacts to our financial system from the derivatives activities of AIG Financial Products. Additional capital is helpful, but it is only the regulation and mitigation of systemic risks that will make our financial system safer.

I urge Congress to not let politics here at home or international commitments made at the Financial Stability Board exacerbate risks to the U.S. financial system and our insurance sector. After five years, it is clear that FSOC serves a useful purpose, but is not perfect, and improvements that make our system stronger should be embraced rather than shunned. If FSOC is unable or unwilling to change its process to develop and provide an "exit ramp" for designated firms, we strongly urge Congress to do so in order to protect financial consumers and the financial system of the United States.

Capital Standards

SIFI designations are not merely academic exercises – they will have real consequences for firms who will now be subject to the Federal Reserve's capital standards. With Congress' passage of the Insurance Capital Standards Clarification Act last December, the Federal Reserve gained flexibility to tailor its capital rules for these companies as well as savings and loan holding companies (SLHC's). The NAIC supported this legislation, and we are hopeful that now the Federal Reserve will use its flexibility to apply capital rules to insurance entities that are consistent with the insurance business model and our legal entity regulation. State regulators, through the NAIC, are committed to assisting the Federal Reserve in this important endeavor. We have had some constructive initial conversations with them and look forward to continued discussions in the future.

For our part, State insurance regulators also support the need to assess the adequacy of an insurance group's capital position as part of coordinated solvency oversight. Through the NAIC's ComFrame Development and Analysis Working Group (CDAWG), we are first developing a group capital calculation to be used as a consistent regulatory analytical and assessment tool. Lessons learned and information garnered from developing this group capital calculation would also be useful in continuing work internationally with ComFrame and domestically with the Federal Reserve Board regarding group capital requirements for certain U.S. groups. We have engaged with industry and consumer stakeholders through our open process and appreciate their constructive feedback.

It is important to remember that capital is not the silver bullet solution – it is one of many tools in the regulatory toolbox to achieve more effective regulation and greater financial stability. Capital standards, by definition, make assumptions and generalize, so over-reliance on them can be dangerous. The business model for insurance is fundamentally different than the business model for banking, and any capital standard should reflect that. While we work with our counterparts at the Federal Reserve, state regulators will continue efforts to improve our capital requirements, analysis, and examination work in ways that best enable us to protect policyholders.

Policyholder Protection Act

Finally, state insurance regulators are very supportive of the Policyholder Protection Act of 2015, H.R. 1478. I want to thank Congressmen Posey and Sherman for their leadership on this issue, and a number of this committee's members for your co-sponsorship. The non-partisan bill clarifies state insurance regulators' authority to wall off insurance company assets within savings and loan holding companies. It also clarifies regulators' options for resolving a systemically risky insurance company under Dodd-Frank. Lastly, it protects the interests of insurance consumers by ensuring that the FDIC's authority to take liens on insurance company assets to facilitate the resolution of a systemic entity won't materially impact the recovery by insurance policyholders. The bill is widely supported by the insurance industry, insurance consumers, state legislators, and the guaranty fund organizations, and we urge its prompt passage so policyholders can remain well protected moving forward, regardless of how their insurer is organized.

Conclusion

As you can see, there is considerable activity by state insurance regulators on a variety of important topics in a variety of venues, as we continue our on-going efforts to improve regulation in the best interests of U.S. insurance consumers. State regulation has a strong 145-year track record of evolving to meet the challenges posed by dynamic markets, and we continue to believe that well-regulated markets make for well-protected policyholders. Thank you again for the opportunity to be here on behalf of the NAIC, and I look forward to your questions.

EMBARGOED FOR DELIVERY

Written Testimony of Michael McRaith
Director, Federal Insurance Office, U.S. Department of the Treasury
House Committee on Financial Services
Subcommittee on Housing and Insurance
"The Impact of Domestic Regulatory Standards on the U.S. Insurance Market"
September 29, 2015

Chairman Luetkemeyer, Ranking Member Cleaver, Members of the Subcommittee, thank you for inviting me to testify today on "The Impact of Domestic Regulatory Standards on the U.S. Insurance Market."

While previous hearings have focused on the international leadership role of the Federal Insurance Office (FIO), FIO also has an important role in domestic insurance matters. FIO monitors all aspects of the insurance industry, including identifying issues or gaps in the regulation of insurers that could contribute to a systemic crisis in the insurance industry or the United States financial system; monitoring the extent to which traditionally underserved communities and consumers, minorities, and low- and moderate-income persons have access to affordable insurance products regarding all lines of insurance, except health insurance; recommending to the Financial Stability Oversight Council (FSOC) that it designate an insurer, including the affiliates of such insurer, as an entity subject to regulation as a nonbank financial company supervised by the Board of Governors of the Federal Reserve (Federal Reserve); assisting the Secretary in administering the Terrorism Risk Insurance Program (TRIP) established in Treasury under the Terrorism Risk Insurance Act of 2002, as amended (TRIA); and consulting with the states (including state insurance regulators) regarding insurance matters of national importance and prudential insurance matters of international importance.

Also, before the Secretary may determine whether to seek the appointment of the Federal Deposit Insurance Corporation (FDIC) as receiver of an insurer under Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Secretary must first receive a written recommendation from the FIO Director and the Federal Reserve. Additionally, FIO and the Federal Reserve are authorized to coordinate annual analyses of nonbank financial companies supervised by the Federal Reserve to evaluate whether such companies have the capital, on a consolidated basis, necessary to absorb losses as a result of adverse economic conditions.

The FIO Director is a non-voting member of the FSOC, and FIO participates directly in the FSOC analysis of broader systemic risks and individual firms. In this work, FIO works closely with staff from other FSOC member agencies, including state regulators and staff of the National Association of Insurance Commissioners.

On September 28, FIO published its 2015 annual report on the state of the insurance industry and related developments. As in the past, FIO's 2015 Annual Report includes sections describing (1) a financial overview of the U.S. insurance industry, (2) developments and issues with respect to consumer protection and access to insurance, (3) U.S. regulatory developments, and (4) international regulatory developments. FIO's 2015 Annual Report also addresses the status of recommendations on how to modernize and improve the system of insurance regulation in the United States, as described in FIO's December 2013 report of the same title.

Any discussion of the U.S. insurance sector and its regulation must begin with the recognition that the United States has the most diverse and competitive insurance market in the world. Thousands of insurers operate in the United States, ranging from small mutual companies operating in a few rural counties to massive global firms engaged in a variety of financial activities. While serving as the Illinois Director of Insurance, I learned firsthand about the importance of small and mid-size insurers to the marketplace and to local and regional economies. Consolidation pressures in the small insurer market segment have existed for years, but we recognize and want to preserve the important contributions of local and regional insurers to consumers and communities.

For 2014, insurers operating in the United States continued to report good financial performance and sound financial condition. In combination, total direct premiums for the life and health (L/H) sector and the property and casualty (P/C) sector were a record aggregate high of $1.23 trillion, an amount equaling 7 percent of the U.S. Gross Domestic Product, a welcome increase following a modest decline in total volume from 2012 to 2013.

In total, the insurance industry reported in 2014 $8.3 trillion in assets, with the L/H sector holding approximately $6.3 trillion, the Health sector holding $248 billion, and the P/C sector holding approximately $1.8 trillion.

Taking into account retained earnings, the sector again reached new, record-high levels of capital and surplus. The L/H sector reported $354 billion in capital and surplus, the P/C sector reported approximately $689 billion in capital and surplus, and the Health sector reported $112 billion in capital and surplus.

Due to lower underwriting gains and large intra-group losses, net income decreased in 2014 as compared to 2013. Investment yield continued to suffer from the current low interest rate environment, but net investment income nevertheless showed a small increase on a higher base of invested assets. To partially mitigate declining investment yields, both L/H and P/C insurers have increased asset allocations towards lower rated and less liquid assets with longer durations, an indication of increased portfolio risks. For both the L/H and P/C sectors, growth in expenses, however, outpaced the increase in total revenues, leading to a decline in operating income as compared to 2013. Accordingly, while the insurance industry in aggregate was profitable, net income and return on average equity were below 2013 levels.

Net written premiums are a principal measure of size and growth in the insurance industry. Net written premiums for the L/H sector totaled $648 billion in 2014, marking a 15 percent increase over 2013. Premiums accounted for 74 percent of total L/H sector revenues in 2014, a mark slightly higher than the historical average of 72 percent. This number also corresponds with the smaller amount of risk ceded to third-party reinsurers in 2014. Notably, solid growth in the sector was driven by a 26 percent gain in annuity premiums and deposits, which also represented the majority of total written premiums for the L/H sector.

For the P/C sector, total net written premiums reached another record level of $503 billion, marking more than a 4 percent increase over 2013, supported by more than 5 percent growth in personal lines.

The combined ratio is an accepted insurance sector metric that compares underwriting performance in the P/C sector, with a ratio of less than 100 percent an indication that premiums covered losses and expenses for the year. In 2014, the P/C sector combined ratio was approximately 97 percent, below 100 percent for the second consecutive year.

Although 2014 included more typical loss results than 2013, the P/C sector was helped by a modestly lower expense ratio. 2014 also reversed a declining trend in the P/C net investment income, with a total of $55 billion, or nearly 12 percent improvement over 2013.

In the aggregate, despite concerns regarding a low interest rate environment, the insurance industry reports financial strength in insurance-related activities, in part due to increased consumer demand during this extended period of economic recovery and job growth.

Measuring global market share by aggregate premium volume, the United States' share of the world market declined from 27.5 percent in 2013 to 26.8 percent in 2014. This development reflects both the continued vibrancy of the U.S. market – far and away the world's largest – and the growth opportunities for U.S.-based insurers in developing economies.

FIO continues to move forward with implementation of the Terrorism Risk Insurance Program Reauthorization Act of 2015 (Reauthorization Act). In light of the amendments to TRIP enacted in the Reauthorization Act, FIO issued interim guidance on February 4, 2015, and has engaged extensively with stakeholders in anticipation of revisions to TRIP regulations. FIO has convened stakeholders, including consumers, industry, state regulators, and data aggregators, for the purpose of sorting through important and novel data collection requirements. In addition, through a Notice in the Federal Register published on April 20, 2015, FIO requested candidates to serve on the Advisory Committee on Risk-Sharing Mechanisms that the Reauthorization Act required Treasury to establish. After reviewing applications and selecting applicants to serve on the Advisory Committee on Risk-Sharing Mechanisms, Treasury announced the members of this important committee on September 23, 2015.

Among its authorities, FIO is authorized to monitor the extent to which traditionally underserved communities and consumers, minorities, and low- and moderate-income persons have access to affordable insurance products regarding all lines of insurance, except health. For this purpose, FIO has focused initially on the affordability and accessibility of personal auto insurance. FIO selected this line of insurance because personal autos are frequently necessary for consumers to commute to and from work, and for many consumers to tend to their daily family needs, like driving students to and from school. On April 10, 2014, FIO published a Notice in the Federal Register seeking comment on how to define affordability for purposes of this monitoring work. After consideration of the comments received, and extensive analysis and engagement with stakeholders, FIO published in the Federal Register a second Notice, on July 2, 2015, seeking comments on a proposed definition of affordability. The comment period closed on August 31, 2015. Twelve comments were received, all of which are being carefully reviewed and considered. Once complete, our hope is to establish a public definition of affordability in order to facilitate greater dialogue on steps that the sector can take to increase access and affordability of personal lines products. Further, with the development of the definition, FIO will work with stakeholders to develop the tools to monitor affordability and accessibility.

In December 2014, FIO released its report on the breadth and scope of the global reinsurance market and the critical role it plays in supporting insurance in the United States. Despite the continuing development of alternative risk transfer mechanisms in the insurance sector, much of the U.S. primary insurance activity is supported by the global reinsurance industry – a market with many important participants based outside the United States. In fact, based on gross premiums ceded, more than 90 percent of the unaffiliated reinsurance of U.S. property and casualty insurers is placed with a non-U.S. reinsurer or a U.S. reinsurer with a non-U.S. holding company parent.

Regarding other work of interest to this Committee, FIO continues to work collaboratively with the state insurance regulators and the Federal Reserve on matters before the International Association of Insurance Supervisors (IAIS). FIO also continues to reach out to stakeholders, providing appropriate and meaningful opportunities to engage in efforts at the IAIS.

Additionally, FIO and the United States Trade Representative (USTR) continue work to develop a process to negotiate a covered agreement. The pursuit of a covered agreement, which relates only to certain prudential insurance or reinsurance matters, is an authority granted by Congress jointly to Treasury and USTR. We will consult with this and other Committees before negotiations commence. FIO and USTR look forward to meaningful engagement with Congress, state regulators, and other stakeholders throughout the covered agreement process. Importantly, our objective in the negotiation of a covered agreement would be to provide tangible benefits for the U.S. insurance industry and consumers.

In all of our work, Treasury priorities will remain the best interests of U.S. consumers, U.S. insurers, the U.S. economy, and jobs for the American people. We welcome the chance to work with this Committee and its excellent staff, and look forward to more discussions on these and other important topics. Thank you for your attention. I look forward to your questions.

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Statement by

Thomas Sullivan

Associate Director

Board of Governors of the Federal Reserve System

before the

Subcommittee on Housing and Insurance

of the

Committee on Financial Services

U.S. House of Representatives

Washington, D.C.

September 29, 2015

Introduction

Chairman Luetkemeyer, Ranking Member Cleaver, and other members of the subcommittee, thank you for inviting me to testify on behalf of the Federal Reserve.

The Federal Reserve welcomes the opportunity to participate in today's hearing, and I am pleased to be joined by my colleagues from the Federal Insurance Office (FIO) of the U.S. Treasury, the National Association of Insurance Commissioners (NAIC), and the independent insurance member of the Financial Stability Oversight Council (FSOC). While we each have our own unique authority and mission, we remain committed to working collaboratively on a wide range of insurance supervisory and regulatory issues.

The Federal Reserve's Role in the Supervision of Certain Insurance Holding Companies

With the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act), the Federal Reserve assumed expanded responsibility as the consolidated supervisor of a significant number of insurance holding companies. As a result of the Dodd-Frank Act, the Federal Reserve is responsible for the consolidated supervision of insurance holding companies that own an insured bank or thrift, as well as insurance holding companies designated for Federal Reserve supervision by the FSOC. The insurance holding companies for which the Federal Reserve is the consolidated supervisor hold about $3 trillion in total assets and one-third of U.S. insurance industry assets. These insurance holding companies vary greatly in terms of size, the types of products they offer, and their geography.

After the passage of the Dodd-Frank Act, the Federal Reserve moved quickly to develop a supervisory framework that is appropriate for insurance holding companies that own depository institutions and promptly assigned supervisory teams to handle day-to-day supervision of those insurance holding companies. We have also acted promptly to commence supervision of the three insurance holding companies designated by the FSOC for Federal Reserve supervision. Our supervisory teams for insurance holding companies are a combination of experienced Federal Reserve staff as well as newly hired staff with insurance expertise. We currently have approximately 90 full-time equivalent employees devoted to the supervision of insurance firms. Many of our supervisors are individuals with substantial prior experience in state insurance departments or the insurance industry. We plan to continue to add staff, as appropriate, at both the Board and the Reserve Banks, to ensure we have the proper depth and experience to carry out our mandate.

Our supervisory efforts to date have focused on strengthening firms' internal controls; corporate governance; and risk identification, measurement, and management. Our principal supervisory objectives for insurance holding companies are protecting the safety and soundness of the consolidated firms and their subsidiary depository institutions while mitigating any risks to financial stability.[1]

The Federal Reserve's Development of Domestic Capital Standards for Insurance Holding Companies

Last year, Congress enacted the Insurance Capital Standards Clarification Act of 2014 (S. 2270), which amended the provision of the Dodd-Frank Act that had required the minimum capital standards for banks be applied to any insurance holding company that controls an insured depository institution or is designated for Federal Reserve supervision by the FSOC. Using the greater adaptability provided by this amendment to the Dodd-Frank Act, the Federal Reserve is

[1] Board of Governors of the Federal Reserve System, Division of Banking Supervision and Regulation (2014), "Incorporation of Federal Reserve Policies into the Savings and Loan Holding Company Supervision Program," Supervision and Regulation Letter SR 14-9 (November 7), www.federalreserve.gov/bankinforeg/srletters/sr1409.htm.

now focusing on constructing a domestic regulatory capital framework for our supervised insurance holding companies that is well tailored to the business of insurance.

We are exercising great care as we approach this challenging mandate. The Federal Reserve is investing significant time and effort into enhancing our understanding of the insurance industry and the firms we supervise, and we are committed to tailoring our framework to the specific business lines, risk profiles, and systemic footprints of the insurance holding companies we oversee. We have increased our staffing and have been engaging extensively with other insurance supervisors, independent experts, regulated entities, and market participants to solicit feedback on various potential approaches to the development of an appropriate consolidated group-wide capital regime for insurance holding companies that would be consistent with federal requirements.

We also play a role, along with our colleagues from the FIO and the NAIC, as members of the International Association of Insurance Supervisors (IAIS). In partnership with the NAIC and the FIO, we advocate for the development of international standards that best meet the needs of the U.S. insurance market. While we view the development of international standards as important to helping improve financial stability and to providing a competitive playing field in an industry that is continuing to develop on a global basis, no standards recommended or developed by the IAIS (or any other international body) apply in the United States unless they are consistent with applicable U.S. law and are adopted in accordance with U.S. law.

In particular, we are committed to developing our insurance capital framework through a transparent rulemaking process that allows for an open public comment period on a concrete proposal. We will continue to engage with interested parties as we move forward.

Cooperation and Coordination among U.S. Supervisors and the Industry

Our primary role in supervision is as the group-wide supervisor for insurance holding companies. Our consolidated supervision and capital requirements will supplement existing legal-entity supervision with a perspective that considers the risks across the entire firm, including risks that emanate from non-insurance subsidiaries and other entities within the group. Our role as the consolidated supervisor does not seek to lessen the critical importance of supervising individual insurance legal entities by the states. We do not regulate the manner in which insurance is provided by these companies or the types of insurance that they provide. Those important aspects of the actual business of providing insurance are the province of the relevant state insurance supervisors.

We conduct our consolidated supervision efforts in a manner that is complementary to, and coordinated with, other insurance regulators. We leverage the work of state insurance regulators where possible and continue to look for opportunities to further coordinate with them. We do this both informally and through formal mechanisms such as supervisory colleges. We also enter into agreements with institutions that allow us to share confidential information with state supervisors. We continue to meet with state insurance departments to discuss supervisory plans and findings for the insurance firms for which we have consolidated supervisory responsibility. In addition to working with the states, we also coordinate with other international and domestic regulators. We have hosted multiple crisis management groups that included participation from other parties such as the state insurance departments, the FIO, and the Federal Deposit Insurance Corporation. Among the topics discussed in these groups was resolution planning for systemically important entities in order to protect policyholders and to mitigate risks to financial stability without putting taxpayer money at risk.

An example of our collaboration with the states is in evaluating companies' Own Risk and Solvency Assessments (ORSAs). Many states have recently enacted legislation that requires state regulated insurers to produce this assessment on a group-wide basis. While we recognize that the ORSA process belongs to the NAIC and the states, it is potentially a useful and valuable tool for us as well because it is fashioned on a group-wide basis. It has helped us to understand some institutions' processes for monitoring, measuring, controlling, and managing risk in a way that avoids unnecessary duplication in our oversight function. We have been meeting with state insurance departments to discuss views on ORSA submissions, and we have appreciated their perspective on these subjects. We will continue our active collaboration with state regulators.

Mr. Chairman, thank you for inviting me here today. I look forward to an active dialogue on these issues with you and other members of the committee.

TESTIMONY OF
S. ROY WOODALL, JR.
INDEPENDENT MEMBER HAVING INSURANCE EXPERTISE
FINANCIAL STABILITY OVERSIGHT COUNCIL

BEFORE THE U.S. HOUSE COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON HOUSING AND INSURANCE

HEARING ENTITLED: "THE IMPACT OF DOMESTIC REGULATORY STANDARDS ON THE U.S. INSURANCE MARKET"

SEPTEMBER 29, 2015

Thank you, Chairman Luetkemeyer, Ranking Member Cleaver, and Members of the Subcommittee for inviting me to appear before you.

I serve on the Financial Stability Oversight Council (Council) as the "independent member having insurance expertise" and am now the second-longest serving voting member on the Council. Apart from the Treasury Secretary, who chairs the Council, all of the other voting members are federal financial regulators. The position I hold was created essentially as a proxy due to the absence of a Federal insurance regulator.

My experience on the Council over the past four years has made me appreciate the importance of the Council in bringing together different perspectives and experiences, and I have enjoyed working with my colleagues on the Council and their staffs in carrying out the overall mission as envisioned by Congress in the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank.)[1]

Some have criticized certain majority views of the Council as reflecting a "bank-centric perspective" through which a financial institution is viewed as either a banking organization, or, if not a bank, then it is lumped together in a catch-all category of "nonbank" or "shadow bank." These critics argue that this perspective results in bank-centric rules that then become regulatory templates to be "tailored" for nonbank financial companies and creates an environment in which federal regulatory policy prescriptions are favored over market-focused and state regulation. I personally believe these criticisms have some merit.

[1] Pub. L. 111-203 (July 21, 2010).

Today, I would like to share with you my "minority" observations on three aspects of the Council's work that have most directly affected the U.S. insurance market: (1) the Council's unwillingness to designate systemically important financial institutions, or "SIFIs," based on the systemically risky activities in which the company actually engages; (2) how this approach is also reflected in the Council's annual reevaluations of the four SIFIs designated thus far, which in my view provide no clear path or "off ramp" for companies to address any systemically-risky activities in which they may be engaged; and (3) what I perceive to be continued international encroachment into our domestic regulatory process.

1. The SIFI Designations of GE Capital, AIG, Prudential and MetLife

We have just passed the fifth-year anniversary of the enactment of Dodd-Frank. In those five years, the Council has exercised its Dodd-Frank authorities[2] to identify and designate *four* "nonbank financial companies" as SIFIs: GE Capital Corporation (GE Capital); American International Group, Inc. (AIG); Prudential Financial, Inc. (Prudential); and MetLife, Inc. (MetLife).[3] In the majority view of the Council, these four companies could potentially pose a threat to the stability of the entire U.S. financial system if they were to experience "material financial distress," in other words, imminent failure.

Under Dodd-Frank, there are two statutory standards, or tests, for designating a company as a SIFI. One test, which was used by the Council in all four of its SIFI designations to date, is whether material financial distress at the nonbank financial company could pose a threat to U.S. financial stability. The other test, which has not been used in any of the four SIFI designations, is what I refer to as the "activities test": whether the nature, scope, size, scale, concentration, interconnectedness, or mix of the company's activities, even without its being in material financial distress, could pose a threat to U.S. financial stability.[4]

I concurred in the designations of AIG and GE Capital, but dissented and disagreed with the Council's designations of Prudential and MetLife. During the Council's consideration of GE Capital and AIG, I began suggesting that it would be better for the Council to designate the companies *not* just based on what might follow if the firms were to fail, but also to review them based on their systemically-risky activities, as Dodd-Frank allows. The majority of the Council, however, was

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[2] 12 U.S.C. §5323.
[3] MetLife is pursuing judicial review of the Council's designation of the company as a SIFI.
[4] 12 U.S.C. §5323(a)(1).

content to designate the companies solely based on what would happen if they were to experience material financial distress. In the case of AIG and GE Capital, in view of what actually happened to these companies during the crisis, I concurred in the SIFI designations based on the first statutory designation test.

However, in my view, the Council should have taken a different approach with Prudential and MetLife, both of which – unlike GE Capital and AIG – weathered the financial crisis and its aftermath reasonably well. Nevertheless, in designating Prudential and MetLife, the Council again focused only on hypothetical and, in some cases, implausible outcomes of what might happen if either were to fail. The companies were not designated based on the "activities test." In my view, the majority's approach was wrong.

As I explained in my dissents to the SIFI designations of Prudential and MetLife, I believe the Council should focus on the *activities* of financial market participants, the interconnections arising from such activities, and any potential heightened risks posed by those activities. Should the Council find that particular activities of nonbank financial firms present systemic risk, then it should review its options under Dodd-Frank: deliver public proclamations, such as through the Council's Annual Report; make recommendations to Congress; make recommendations to primary regulators, formally or informally, aimed at those activities; designate the activities themselves as systemically important; or designate as SIFIs those companies engaged in such activities (or mix of activities) that could pose a threat to U.S. financial stability.

Likewise, I believe the rationale for a company's SIFI designation (what the Council calls the "basis document"), should specifically identify the systemically risky or disfavored activities, or the combination of such activities, that caused the company to be branded a SIFI, thereby providing actionable guidance as to which activities (or mix of activities) need to be addressed. This is not just so the SIFI can "exit" enhanced supervision (the so-called "exit ramp" or "off ramp") – but, more importantly, so that the financial system can be made safer and less vulnerable to systemic threats, which, of course, in turn is good for long-term, stable economic growth and job creation.

By designating SIFIs based solely on what could happen if they were to fail – and *not* on specific activities or combinations of activities – the SIFIs do not know which activities they need to address (as some of the existing SIFIs have stated publicly). More importantly, other companies providing similar financial services do not know which activities to avoid or guard against, nor do the primary regulators, including those actively engaged in field-level examination of SIFIs and other large financial firms.

It is often said that the Council is a young institution and is still learning. I am encouraged that the Council has at times – *albeit* belatedly - recognized that focusing on activities is the better approach. For example, with respect to nonbank asset management companies, the Council has put on hold consideration of SIFI designations of individual asset managers in favor of conducting a comprehensive study of potential systemic risks associated with asset management products and activities, industry-wide.

Thus, while any further SIFI designations appear to be on hold for now, we have a situation in which four nonbanks have been judged to be SIFIs under a designation test that has been subsequently – and rightly in my view – temporarily set aside. As explained below, one of the current SIFIs is closer to being "de-designated." If that happens, all of the remaining nonbank SIFIs would be insurance companies that were designated under the now set-aside standard. But I believe it is not too late to reverse course. Indeed, in its annual reevaluations of the three insurance company SIFIs, I have urged the Council to change its approach and to conduct these reevaluations, based not on what might happen if the companies were to fail, but instead on the companies' activities, and to provide each company with actionable guidance on how it could reduce its systemic importance.

*2. **Annual Reevaluations Required by Congress***

Dodd-Frank requires the Council to conduct *annual* reviews of each existing SIFI designation to determine whether the company could still pose a threat to U.S. financial stability. Because a majority of the Council decided to designate the four current SIFIs solely under the "material financial distress" test (which, as noted, focuses on what could happen if the institution were to fail), they have continued to apply that test – exclusively - in conducting the annual reconsideration of these SIFI designations. I think we should all be able to agree that the fundamental objective of the systemic regulatory regime embodied in Dodd-Frank is that, over time, the companies own actions, together with the overlay of enhanced prudential supervision conducted by their primary regulator and the Board of Governors of the Federal Reserve System, will reduce the companies' so-called "systemic footprint" in such a way as to allow for them to shed their SIFI designation. But, to achieve that goal, we have to be clear – both to the companies and to the public – about how we plan to get there. In other words, that has to be a plan, and at least from where I sit, it is not clear to me, or the SIFIs, what that plan is.

By designating companies under these failure-based scenarios, it seems to me that the companies may never be able to do enough to have their SIFI designations rescinded. In reality, balance sheets can grow stronger, capital positions can grow, liquidity positions can improve, leverage can drop, yet-to-be regulatory standards and stress tests can be satisfied. Yet, when tested under a scenario of presumed failure where all the cash is gone, all policy and contract holders run, and regulators do not intervene, companies could have as much cash as the very largest financial firm in the world and still not pass the test. Accordingly, I have to wonder whether, under the current approach, there is any viable option for ultimate de-designation.

Unfortunately, I believe the restructuring plans announced by GE Capital present a case study of what happens when a company is confronted with this unpassable test. GE Capital has begun executing, a comprehensive transformation of its businesses. It has publicly disclosed plans to significantly reduce its size, complexity, interconnectedness, and counterparty and debt holder exposures. The orderly sell-off of key financial businesses and assets, as well as the exit from certain markets and activities, will significantly change the nature and extent of the company-specific risks and resolution challenges previously identified by the Council in its designation. Once those plans have been executed, I suspect that the much-smaller GE Capital will pose materially diminished systemic risk.

In light of the singular focus of the Council's SIFI designation based on assumed "material financial distress," it may be difficult for the Council to conclude in a future annual reevaluation that material financial distress at a much smaller and much less interconnected GE Capital could still pose a threat to the U.S. financial system. However, viewed from an activities focused perspective (for which I have been an early and strong proponent), the financial activities and assets to be shed by GE Capital will not be eliminated, but will instead merely migrate to other financial market participants; and those companies, many of which are not subject to comparable regulation, will, in turn, get larger and more interconnected.

In my opinion, a SIFI should not be forced to drastically transform itself, exit markets, divest, downsize, and transfer financial activities to other parts of the financial system as the only path to SIFI de-designation. Instead, I believe the Council should clearly set forth in its annual reviews, other paths and corrective actions that could be taken to reduce and eventually eliminate whatever risk of financial instability the SIFI may pose to the U.S. financial system.

I believe it is vitally important for the Council to provide this type of forward guidance to designated companies, as well as to others operating in financial markets, and to identify specific, concrete, measurable positive developments in its annual reevaluations, including any activities that may have changed or other actions taken that have resulted in a reduction of overall systemic riskiness. Such an approach could encourage further appropriate actions by the companies and their officers and directors.

3. International Developments

International organizations such as the International Association of Insurance Supervisors (IAIS), and the Financial Stability Board (FSB) are working to promulgate capital standards for internationally-active U.S. insurance companies, with a consensual commitment on behalf of the U.S. to the implementation of substantially equivalent domestic standards. I personally worry that the scope of Federal efforts to develop and coordinate Federal policy on international insurance prudential matters has gone too far in displacing authorities that Congress has reserved to the States and State regulators. Beginning with the McCarran-Ferguson Act in 1945, and later reaffirmed in both the Gramm-Leach Bliley Act (1999) and Dodd-Frank (2010), Congress has explicitly entrusted the States and State insurance regulators with the safety and soundness of insurance companies and the protection of insurance consumers.

In my view, the negotiation of these types of international agreements by some Federal agencies has thus far taken place in an atmosphere of opaqueness that I believe to be at odds with our traditional principles of openness, transparency, and oversight in insurance regulation. As the Council's only voting member with insurance expertise, I have a statutory obligation to monitor international insurance developments.[5] And yet, I have been deliberately prevented from playing any non-public role at the international level.[6]

Consequently, like Congress and the public at large, I do not know where this process is headed. I am concerned, however, about the potential negative impacts that may follow from imprudent, hurried and untested capital directives developed not by our own State insurance regulators or Congress – but rather by international

[5] 12 U.S.C.§5322(a)(2)(D).

[6] *See* United States Government Accountability Office, "International Insurance Capital Standards, Collaboration among U.S. Stakeholders Has Improved but Could Be Enhanced," (GAO Report 15-534, June 2015). This report, requested by the Chair of this Subcommittee, states on p. 46 that "... U.S. IAIS members disagreed on whether the FSOC independent member with insurance expertise would be a relevant participant in U.S. collaborative efforts ... ."

organizations and foreign regulators that do not understand the fundamentally different basis on which the U.S. insurance regulatory system operates. As the largest insurance market in the world, the U.S. should be driving the standards that the rest of the world ultimately adopts, not the other way around.

Congress is right to be concerned about these ongoing efforts by foreign organizations that could be used to mandate changes in decisions that Congress has specifically left to our State regulators, or have been reserved for Congress itself to decide. Such concerns should not be limited to insurance regulation. Indeed, foreign regulators also appear to have U.S. financial market regulation in their sights. Several Commissioners at the Securities and Exchange Commission (SEC), for example, have been outspoken about this threat and it now seems that the IAIS's counterpart, the International Organization of Securities Commissions (IOSCO) and the FSB have recently reversed course and will not – at least for the time being – be pursuing designations of individual asset management companies as Global-SIFIs.

Clearly, international *fora* can and do play an important role in regulatory coordination given the increasingly global interconnections of the financial system. However, when these international bodies seek to assume a position of primacy *vis-à-vis* the domestic regulatory authorities and regimes of sovereign countries, I think we should be concerned that the effort has gone awry, even if well-intentioned at the outset.

In my opinion, it is very important that Congress consider a clear statutory framework for: (1) broader U.S. participation at these various foreign organizations, particularly the FSB; (2) establishing appropriate parameters to govern such participation and ensure that it is aligned with the domestic regulatory authorities established by Congress; and (3) increased transparency and accountability to both the Congress and the public.

Conclusion

I appreciate the efforts of the Chairman and Members of this Subcommittee in evaluating the many important issues associated with the supervision and regulation of insurance companies, both from prudential and systemic risk perspectives. I look forward to continuing to work with Congress, my colleagues on the Council, and our state insurance regulators on these critical issues. Thank you. I look forward to answering any questions you may have.

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Testimony of Elizabeth Brill, MAAA, FSA
Chairperson, Solvency Committee
Risk Management and Financial Reporting Council
American Academy of Actuaries

Submitted for the Record

U.S. House Financial Services Subcommittee on Housing and Insurance Hearing
Titled "The Impact of Domestic Regulatory Standards on the U.S. Insurance Market"
September 29, 2015

Chairman Luetkemeyer, Ranking Member Cleaver, and distinguished Members of the Subcommittee:

As the chairperson of the American Academy of Actuaries'[1] Solvency Committee, I appreciate the opportunity to provide this written testimony for the Subcommittee's Sept. 29 hearing: "The Impact of Domestic Regulatory Standards on the U.S. Insurance Market." U.S. insurance markets are strong, due in large part to effective regulation and oversight based on sound solvency and actuarial principles. My testimony will focus on recent proposals to regulate U.S. insurers' capital and solvency in order to promote financial stability.

Insurance Capital Standards Clarification Act of 2014

First, I commend the action of Congress in passing the Insurance Capital Standards Clarification Act of 2014 during the 113th congressional session. The statute provides the Board of Governors of the Federal Reserve System with the much needed authority to differentiate regulatory capital requirements between banks and insurers.

Insurance companies operate in different markets under different accounting constructs and face different risks than other financial institutions. The business models for insurance companies and other financial institutions have important differences relative to, among other things, the needs of consumers, the nature of risks transferred, and the timing and certainty of cash flows. Regulation focused on risks that are not necessarily significant to insurers could drive changes to their product offerings, impact policyholders by impeding competition and creating affordability

[1] The American Academy of Actuaries is an 18,500+ member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

and accessibility problems, and lead to actions that increase the economic risks to insurers and their policyholders. Furthermore, some risks could be more significant for insurers than other financial institutions, particularly with respect to liabilities that are sensitive to changes to interest rates. As such, applying the same regulations or capital requirements to insurers and other financial institutions, including banks, is not appropriate.

Basic Solvency Principles for Capital Standards

Although U.S. insurers are generally regulated at the state level, both the National Association of Insurance Commissioners (NAIC) and the Board of Governors of the Federal Reserve System are developing insurance regulations for large U.S. insurers to meet certain group capital requirements. To help guide regulators in connection with their development processes, the Academy's Solvency Committee has created a comprehensive set of basic principles that it believes are essential to the development of effective group solvency and capital standards for insurers. Adhering to these principles will help policymakers create insurance capital standards that are appropriate for insurance business models and do not negatively impact U.S. insurance markets or consumers. The committee also believes that the basic principles highlighted below should be taken into account during the development process for international insurance regulations and capital standards.[2] These principles include:

1. A group solvency regime should be **clear regarding its regulatory purpose and goals.** For example, the purpose could be to protect policyholders, enhance financial stability, ensure a competitive marketplace, provide a level playing field, identify weakly capitalized companies, rank well-capitalized insurers, improve risk management practices and procedures, or some combination of the above. The regulatory purpose and goals will aid in the development of a standard itself, the associated regulatory actions, and priorities.

2. Any **metrics, information, or other output** of a group solvency standard should be useful to all relevant parties, including regulators, management, shareholders, and rating agencies.

3. A group solvency regime should **promote responsible risk management** in the regulated group and **encourage risk-based regulation.** For example, a solvency regime should recognize risk-mitigation activities, such as asset/liability matching, hedging, and reinsurance. Actuarial functions are critical in the risk management process and their role should be well defined, as it is in the state-based reserving and solvency framework. Actuaries can and should identify where factor-based systems could miss emerging risks, set reasonable boundaries around estimates and modeling, and, as appropriate, render actuarial opinions.

[2] For more information on application of these principles to international standards, please refer to previous Academy testimony to this Subcommittee for the April 29, 2015, hearing on "The Impact of International Regulatory Standards on the Competitiveness of U.S. Insurers." This testimony offered the Solvency Committee's perspectives on the International Association of Insurance Supervisors' (IAIS) capital standards setting activities.

4. Methods should recognize and take into consideration the **local jurisdictional environments** under which members of an insurer group operate, including the local regulatory regime, product market, and economic, legal, political, and tax conditions.

5. A group solvency standard should be **compatible across accounting regimes**, given the technical and political uncertainties in achieving uniform standards.

6. A group solvency standard should **minimize pro-cyclical volatility** so as to avoid unintended consequences on insurance groups, insurance markets, and the broader financial markets.

7. A group solvency standard should present a **realistic view of an insurance group's financial position and exposures to risk** over an agreed-upon time frame.

8. All **assumptions** used in any capital or solvency model should be **internally consistent**.

9. It is more important to **focus on the total asset requirement** than the level of required reserves or capital on a separate basis. The focus should be on holding adequate total assets to meet obligations as they come due. Whether a jurisdictional standard requires the allocation of these assets to liabilities versus capital/surplus should be irrelevant to the overall solvency regime.

10. It must be **demonstrated that the capital held is accessible**, including in times of financial or economic stress, to the entity facing the risk for which the capital is required.

In addition, the American Academy of Actuaries provided written testimony[3] on the challenges associated with developing entity-level capital requirements for insurers to the Senate Banking Subcommittee on Financial Institutions and Consumer Protection for the March 11, 2014 hearing on "Finding the Right Capital Regulation for Insurers." This testimony contained an overview of the NAIC's risk-based capital (RBC) requirements, which are currently in effect in the United States.

Board of Governors of the Federal Reserve System Capital Standards Proposals

Currently, the Board of Governors of the Federal Reserve System is in the process of developing capital standards for non-bank systemically important financial institutions (SIFI). The Academy's Risk Management and Financial Reporting Council is closely following the development of these standards and other regulatory proposals, although there are no formal proposals from the Board at this time.

[3] http://actuary.org/files/RMFRC_HouseTestimonyHines_031114.pdf

NAIC Group Capital Standards Proposals

The NAIC has been actively developing proposals related to group capital calculations, in addition to the regulatory proposals under development by the Board of Governors of the Federal Reserve System.

The July 23, 2015, discussion draft[4] from the NAIC's ComFrame Development and Analysis (G) Working Group (CDAWG) offered an overview of potential advantages and disadvantages of three possible factor-based approaches to a U.S. group capital calculation for insurers:

(1) Aggregation of existing RBC calculations within a group;
(2) A consolidated group RBC calculation based on U.S. statutory accounting principles; and
(3) A consolidated group RBC calculation based on Generally Accepted Accounting Principles (GAAP).

In the Solvency Committee's view, each of these factor-based approaches offers potential as a component of a new group capital measure that leverages the existing U.S. system of RBC. However, the committee has urged the NAIC, in addition to exploring potential capital measures based on RBC, to include a cash flow stress testing methodology in its final recommendations. The committee believes that a hybrid approach, incorporating both factor-based and cash flow methodologies, as originally proposed by the NAIC in late 2014,[5] has significant merit.

Factor-based approaches like the NAIC's RBC requirements are useful regulatory tools, but also have significant limitations. For example, it is not practical to expect that factors can be designed to take into account every nuance of risk across insurers. In contrast, a cash flow approach based on internal models can be calibrated to an insurer's actual risks. The cash flow approach, of course, has its own disadvantages. Comparable results may be elusive because risks can differ dramatically from insurer to insurer, and internal models require significant resources to implement and monitor from both regulators and insurers.

A hybrid approach offers a potential path that draws the best features from RBC and cash flow methodologies. For example, state regulators could use an RBC methodology to establish a minimum required level of capital that applies to all U.S. insurers. A cash flow methodology then could be used to establish a prudent capital level above this minimum. Such an approach could maximize the advantages of each methodology while minimizing the disadvantages. In addition, a well-designed RBC-based minimum could give regulators the flexibility to design a cash flow or similar prudent capital methodology that accounts for the significant economic differences between life insurers, property and casualty insurers, and health insurers.

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Thank you for this opportunity to discuss the impact of domestic regulatory standards on U.S. insurers. Actuaries have worked for many years with insurance and other financial sector

[4] http://www.naic.org/documents/committees_g_cfwg_related_us_group_capital_calc_draft.pdf
[5] http://www.naic.org/documents/committees_g_cfwg_exposure_disc_paper_us_grp_cap_method_concepts.pdf

policymakers to help develop prudent laws and regulations that address insurer solvency, including capital requirements. Actuarial expertise remains crucial to the creation of both domestic and international insurance regulatory standards.

If you have any questions or would like to discuss these issues in more detail, please contact Lauren Sarper, the Academy's senior policy analyst for risk management and financial reporting, at 202-223-8196 or sarper@actuary.org.

Independent Insurance Agent®

Statement on Behalf of the
Independent Insurance Agents and Brokers of America
Before the
United States House of Representatives
Committee on Financial Services Subcommittee on Housing and Insurance

September 29, 2015

For over a century, the Independent Insurance Agents & Brokers of America (IIABA or the Big "I") has supported state regulation of insurance – for all participants and for all activities in the marketplace – and the foundation of this state system remains as strong as ever and continues to offer considerable benefits. State regulators possess unmatched regulatory experience and expertise, outnumber their banking and securities sector counterparts by a wide margin, handle millions of inquires and questions from consumers every year, and understand the local concerns and unique conditions facing the citizens in their states. State regulation has a long and stable track record of accomplishment – especially in the vital areas of solvency regulation and consumer protection – and its benefits and merits have never been more apparent than they are today. Even during the most tumultuous of times, state insurance regulators have ensured that insurers were solvent, that claims were paid, and that consumers were protected. IIABA remains dedicated to preserving state insurance regulation, and we believe the benefits and attributes of the system dramatically outweigh any deficiencies.

IIABA appreciates having the opportunity to provide our perspective on several of the initiatives and proposals that have been and are being addressed by the committee, and we look forward to working with you on any insurance-related legislation that might advance through the legislative process.

NARAB II

After many years of pursuing the enactment of the "NARAB II" legislation, the independent insurance agent and broker community anxiously awaits the implementation of this much-anticipated measure. Thanks to the important work and persistence of this committee, the NARAB II proposal was part of a legislative package that included the multiyear reauthorization of the Terrorism Risk Insurance Act and was signed into law on January 12, 2015. These particular provisions will ultimately result in the establishment of the National Association of Registered Agents and Brokers (NARAB) and should address many of the licensing compliance challenges faced by producers that operate in multiple states.

State law requires insurance producers to be licensed in every jurisdiction in which they operate, and those who conduct business in multiple states often face inconsistent standards and needlessly duplicative processes. These requirements are costly, burdensome, and time-consuming and hinder the ability of agents and brokers to effectively and efficiently serve clients. The new law responds to these problems by establishing a non-governmental, membership-based, nonprofit entity known as NARAB. This entity will ultimately create a one-stop licensing compliance mechanism for agents and brokers who operate in multiple jurisdictions, while states remain responsible for the oversight and day-to-day regulation of the marketplace and its actors.

Membership and participation in NARAB will be voluntary, but an agent or broker must first become a member of the organization in order to take advantage of its benefits. Once approved for membership, a producer will be able to utilize NARAB to obtain the regulatory authority needed to operate in any jurisdiction. NARAB members will be required to pay state licensing fees, but states may not impose any other licensing, application, or market entry-related requirements on members. The law also leaves insurance regulation in the hands of state officials. State regulators will continue, for example, to regulate marketplace conduct, oversee the actions of producers, investigate complaints, and take action against those who violate the law.

NARAB will be established and governed by a board of directors composed of eight insurance regulators and five private sector representatives, and initial and future board members will be appointed by the President and confirmed by the Senate. The board of directors is responsible for creating and operating NARAB in a manner that is consistent with the clear and specific parameters of the statute. The board will be required to operate transparently, and it must consider and develop bylaws and standards under procedures that are similar to those required by the Administrative Procedure Act. The board must, for example, expose all proposed bylaws and standards for public comment before taking final action.

The initial board has not been appointed, and, as a result, the work toward NARAB's establishment and the implementation of the law has not yet begun. The statute required the selection of the initial board members no later than 90 days after the date of enactment (or April 12, 2015), but no appointments have been made in the 260 days since the measure was signed. While we recognize that a proper amount of due diligence and reasonable scrutiny is required in connection with these appointments, it is also important to remember that NARAB board members do not possess the type of policymaking authority or discretion afforded to other Presidential appointees. The NARAB board, for example, will have limited authority, a discrete mission, and it will receive no government funding. Since the implementation of the act cannot truly begin until the board is put into place, IIABA urges the White House to act swiftly and to make these initial appointments as quickly as possible.

Flood Insurance

The Big "I" supports the National Flood Insurance Program (NFIP) and is proud that independent agents serve as its distribution force. The Big "I" also believes that the private market has a limited role to play in complementing the NFIP and therefore supports H.R. 2901, the "Flood Insurance Market Parity and Modernization Act" introduced by Reps. Dennis Ross (R-Florida) and Patrick Murphy (D-Florida).

This bill is particularly important to the Big "I" because it clarifies that a private flood policy can satisfy the mandatory purchase requirement for flood insurance under the terms of the NFIP. Mandating that state insurance regulators will be in charge of determining what is "acceptable" private market flood insurance helps to provide additional clarity to the program. Finally, ensuring that policyholders will not lose their flood insurance subsidies or their grandfathered status if they decide to move their coverage from the NFIP to a private market policy and one day wish to return to the NFIP is a vitally important feature to agents and the customers they serve. This language may also incentivize consumers to explore private market flood insurance coverage where it is warranted.

Policyholder Protection Act

The Big "I" supports H.R. 1478, the "Policyholder Protection Act" introduced by Reps. Bill Posey (R-FL) and Brad Sherman (D-CA). This bipartisan bill clarifies some ambiguities within the Dodd-Frank Wall Street Reform Act (Dodd-Frank) to allow state regulators to protect insurer assets designated for insurance consumers and not be used to "bailout" non-insurance related failures within a diversified financial services company. Specifically, the bill ensures that capital intended to pay the claims of policyholders is protected and not subject to risk taking elsewhere in the firm. It also reaffirms the authority of state regulators to approve transactions within the insurance company, such as liens on assets, to protect policyholders. This common sense legislation further reinforces the strong consumer protections contained within the state oversight model.

Expansion of the Risk Retention Act

The Big "I" opposes legislation soon to be introduced by Reps. Dennis Ross (R-FL) and Ed Perlmutter (D-CO) that would expand the Liability Risk Retention Act (LRRA) to allow many Risk Retention Groups (RRGs) to offer all forms of commercial insurance. Currently, RRGs are only permitted to offer commercial liability coverage.

LRRA was enacted by Congress to address the significant liability insurance crisis that plagued the U.S. economy during the early-to-mid 1980s. The country faced a severe and widely acknowledged marketplace collapse, and many businesses at the time were simply unable to obtain adequate commercial liability insurance. The act authorized businesses and individuals engaging in similar commercial activity and sharing similar liability exposures to join together as RRGs and to write liability coverage for their members. The LRRA also preempted state insurance law in significant ways and exempted RRGs from nearly all forms of regulatory oversight in any state outside of their domiciliary jurisdictions.

RRGs are exempt from many of the regulatory requirements that other commercial insurers must comply with, and they face a far less rigorous level of oversight and have far lower compliance costs as a result. RRGs are permitted to operate nationally, yet they are regulated almost exclusively by their home state regulators. They are exempt from licensing requirements and most other forms of oversight (including rate and form review, solvency regulation, etc.) in the other jurisdictions in which they operate. In addition, states are prohibited from requiring RRGs to participate in the guaranty fund system that is meant to protect consumers in the event of insurer insolvencies. This lack of oversight has been consistently criticized by many state insurance regulators, particularly as numerous RRGs have gone insolvent.

Given these competitive advantages and their ability to operate largely outside of the state regulatory framework, it is no wonder that some RRGs are asking the federal government to further preempt state law and further extend the preferential treatment they receive in relation to other insurers. However, despite this insular desire to expand their business model, there is no established marketplace need and no current justification for broadly expanding the authority and scope of insurance products that RRGs may offer. There is certainly no "crisis" in the current commercial market (as there was with the commercial liability insurance crisis in the 1980s), and the enactment of this proposal will needlessly create an uneven playing field within the insurance marketplace and put consumers at risk.

NAMIC®

NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

Statement

of the

National Association of Mutual Insurance Companies

to the

United States House of Representatives

Committee on Financial Services

Subcommittee on Housing and Insurance

Hearing on

The Impact of Domestic Regulatory Standards on the U.S. Insurance Market

September 29, 2015

The National Association of Mutual Insurance Companies (NAMIC) is pleased to provide comments to the House Financial Services Subcommittee on Housing and Insurance on issues impacting the property/casualty insurance industry.

NAMIC is the largest and most diverse property/casualty trade association in the country, with 1,300 member companies including regional and local mutual insurance companies on main streets across America and many of the country's largest national insurers. NAMIC members serve more than 135 million auto, home and business policyholders, with more than $208 billion in premiums accounting for 48 percent of the automobile/homeowners market and 33 percent of the business insurance market.

Introduction

The issues which impact the property/casualty insurance industry are varied and sundry. This fact becomes clear when considering how the industry interacts with the broader economy as a whole. The constituents of the property/casualty industry include policyholders (individuals and businesses, as well as institutions and governments), taxpayers, insurance companies, agents, brokers, reinsurers, risk managers of all disciplines and others affected by the insurance underwriting process. All can be, and frequently are, impacted by market distortions caused by ill-conceived regulation, litigation, and other external forces.

Insurance is the spreading of the risk of loss, from one person or entity to another and among large numbers of people and entities, 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 and organizational failure and personal financial ruin due to fortuitous loss, natural catastrophe or lawsuit would be dramatically higher, leading to far fewer start-ups and less economic continuity or growth. Insurance is the mechanism that has allowed people and organizations to take the risks of owning property or starting a business or service that are so critical to the nation's economic vitality and in many cases, social wellbeing.

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. The industry employs millions of people and is a significant source of state tax revenue. Through a significant portion of their 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.

Despite the financial crisis and weak economic recovery, the property/casualty insurance market remains highly competitive and well-capitalized. 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, 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.

An example of such a business model, and one of the common threads that bind NAMIC members together, is 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 enhancing their quarterly earnings report.

The property/casualty insurance industry is unique among the financial services industry and NAMIC is pleased that the committee is focusing on the issues it faces. It is clear that the industry plays a key role in the economy and every effort should be made to ensure that its markets are functioning optimally. To that end, we respectfully recommend the following issues to your attention and request that Congress remain focused on preventing unneeded and damaging interference while pursuing policies which contribute to a well-functioning insurance market.

Designation of Systemically Important Financial Institutions

Since the financial crisis occurred, NAMIC has consistently pointed out that traditional property/casualty insurance products and services do not pose systemic risk and the legislative history of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") is unambiguous that Congress agreed with us on this point. However, the Financial Stability Oversight Council ("FSOC") has now designated three U.S. nonbank financial companies as systemically important financial institutions ("SIFIs") that they have deemed systemically risky to the U.S. economy. The focus of the FSOC should remain on identifying true systemic risk, and NAMIC believes Congress can and should conduct vigorous oversight of the FSOC designation process to ensure that this is the case. If it is decided that further legislation is needed to ensure that the intent of Congress is honored, NAMIC would support such an effort.

In particular, NAMIC is concerned with the FSOC's designation decisions regarding insurance groups. Rather than conducting a transparent and meaningful analysis of systemic risk factors, the council has instead focused on issues relating to the size of the company and on hypothetical and arguably implausible scenarios under which material financial stress at the company would pose systemic risk to the economy. The insurance designations were all the more troubling given that they were made over the strong objections of both FSOC's Independent Member Having Insurance Expertise and the non-voting State Insurance Commissioner Representative. The fact that the FSOC ultimately disregarded the expert advice of those council members with actual insurance expertise is a sure sign that the designation process is flawed.

Going forward in an oversight and/or legislative capacity, Congress should remember three key points. First, traditional insurance activities are simply not systemically risky. Property/casualty insurers in particular have low leverage, are not interconnected with other financial firms, do not pose a "run-on-the-bank" threat, are highly competitive with low market concentration, have low failure rates, and have their own effective and industry-financed resolution system. Further, state insurance regulators have a number of options to mitigate systemic risk and deference to the functional regulators was a key aspect of Dodd-Frank and should be taken seriously.

A corollary to the first point is that size alone does not create systemic risk. NAMIC remains very concerned that the FSOC will eventually create a tier of "too-big-to-fail" companies simply because they are large without adequately analyzing other more significant factors indicative of systemic risk. Size matters far less than whether a financial institution is engaged in highly risky activities, heavily interconnected, highly leveraged, or particularly concentrated.

Finally, NAMIC believes that it was the intent of Dodd-Frank to reduce systemic risk to the U.S. economy, and as such, that should be the goal of the FSOC. If this is the goal, the FSOC should commit to engaging in a straightforward and transparent designation process with clear rationales which specifically identify the activities the council considers to be particularly risky and how heavily those activities are being weighted in the final decision. The FSOC should work with companies on actions that would reduce systemic risk before, during, and after consideration of a company for designation. Once a company has been designated, a process is needed to give the company a reasonable roadmap for eliminating the activities that led to the determination, and providing the company the opportunity to have the designation removed.

Federal Reserve Group Capital Standards

Before the passage of Dodd-Frank, 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 by Dodd-Frank and the Federal Reserve Board was given responsibility for holding company level 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. The risk and exposure of insurance companies and the nature and utilization of their assets and liabilities are significantly different from banks.

Under Dodd-Frank, the Federal Reserve is tasked with producing minimum capital standards for its SLHCs and nonbank SIFIs and for a time, it appeared as though the standards would be the same as for those produced for bank holding companies. In regulation, as in most things, one size does not fit all, and consequently, the Federal Reserve system of supervision needs to be tailored to this economic reality.

Fortunately, Congress passed the Insurance Capital Standards Clarification Act of 2014 and President Obama signed it into law in December of last year. This legislation allowed the Federal Reserve to avoid imposing on insurers capital standards designed for bank holding companies.

The Federal Reserve is now in the process of producing its tailored capital standards for SLHCs and SIFIs. In our view, that solvency regime should fulfill the intent of Congress by incorporating existing regulatory and accounting structures at the state level, thereby explicitly reflecting the insurance business model. Specifically, we strongly support the adoption of a baseline group capital approach that relies on the state risk-based capital regime for domestic insurance operations, the appropriate jurisdictional capital regime for international insurance operations, and the Basel III banking capital requirement for depository operations of federally supervised insurers. Ideally, the Federal Reserve would take these requirements and combine them into an "aggregated activities-based approach," reflecting the business model of insurance and the long-standing state regulatory framework applied to every sector of the insurance industry. In any case, NAMIC believes the Federal Reserve needs to undertake a deliberate process for this domestic rulemaking, including an advanced notice of proposed rulemaking for both insurance SLHCs and SIFISs, before a notice of proposed rulemaking.

Financial Regulatory Improvement Act

In May, the Senate Committee on Banking, Housing, and Urban Development passed S. 1484, the Financial Regulatory Improvement Act of 2015 ("FRIA"). Then on July 23, the Senate Appropriations Committee passed its Financial Services and General Government Appropriations Act which included the FRIA language. NAMIC supports the passage of FRIA and was pleased to see the bill move forward along two different legislative tracks.

In particular, NAMIC supports Title IV of FRIA, the three provisions of which deal exclusively with insurance. The first provision is a Sense of Congress which affirms the primacy of the proven state-based system of insurance regulation under the McCarran-Ferguson Act. NAMIC has long been a supporter of the state-based system which, though not perfect, has fostered a competitive insurance market in the U.S. and worked to protect companies and policyholders alike. Language affirming the success of our system is important.

The second provision is legislation which would amend the procedural requirements of the Bank Holding Company Act ("BHCA") for federal banking regulators seeking to transfer or move assets from an insurance company organized as a thrift holding company to a troubled affiliated bank. Known as the Policyholder Protection Act, the provision would provide the same protections to insurers organized as thrift holding companies already in place for insurance companies under bank holding companies ("BHCs).

Specifically, the BHCA prohibits the transfer of funds if the state insurance regulator notifies the holding company and the Federal Reserve Board in writing that such action would have a material, adverse effect on the financial condition of the insurance company. The BHCA currently only refers to BHCs and SLHCs; however, most insurers affiliated with banks are organized as thrift holding companies, not bank holding companies. The laws governing thrift holding companies do not provide the same procedural protections as the BHCA.

NAMIC has long supported insulating the funds and assets of insurance companies within consolidated control groups. We remain concerned about any attempt to use insurance assets designed for the protection of policyholders and claimants to offset activities in other affiliated organizations. Tapping the assets, particularly without the consent of the insurance regulator, would inappropriately threaten the financial structure underpinning the insurance operations and undermine consumer confidence in the insurance industry. For these reasons, NAMIC supports the Policyholder Protection Act and respectfully urges members of the committee to do the same.

Finally, the third provision of Title IV of the FRIA, S. 1068, the International Insurance Capital Standards Accountability Act, aims to inject transparency into discussions taking place at international regulatory bodies. Since the financial crisis, there has been increasing activity at the international level regarding the regulation of insurance companies with the International Association of Insurance Supervisors ("IAIS") at the center of many of these discussions. After the financial crisis the IAIS began work on a Common Framework for the Supervision of Internationally Active Insurance Groups, also known as ComFrame. This new framework, which started as new standards for cooperation and coordination among insurance supervisors, became a series of new requirements for these internationally active insurance groups, including a planned global capital standard.

In NAMIC's view there are serious questions that remain about the feasibility and even the need for a new, one-size-fits-all, group-level capital standard for companies that happen to write internationally. In particular, the type of standard being discussed at the IAIS does not fit the U.S. regulatory model and will likely do nothing but add costs for policyholders and potentially create an un-level playing field. In our view, both the motivation and urgency behind the entire project are questionable.

At the very least the U.S. should be seeking to export its own system of regulation rather than import one designed by foreign bodies. To that end, NAMIC urges that the U.S. representatives at the IAIS advocate for a pause to the process so that the Federal Reserve – the agency tasked with producing a domestic, group-level capital standard for the SLHCs and SIFIs it regulates – can focus on finishing its work on the domestic capital standard. Getting it right at home first will give the U.S. representatives something to fight for abroad. At this point, it is not clear what positions they are taking nor how they are deciding on an agenda for which to advocate.

Covered Agreements

Dodd-Frank authorized the U.S. Treasury Department, the United States Trade Representative ("USTR") and the Federal Insurance Office ("FIO") to negotiate and enter into international agreements on insurance regarding prudential measures. To date, there have been no covered agreements entered into under Dodd-Frank, although a covered agreement on reinsurance collateral is under consideration. Exactly how these agreements will be negotiated, entered into, and applied are subject to general guidelines in Dodd-Frank, but questions remain concerning these agreements, their application and the rights of parties to participate in and/or challenge these agreements.

Specifically, a covered agreement is a new type of international agreement defined as a written agreement between the U.S. and one or more foreign governments or regulatory entities that relates to the recognition of prudential measures that "achieves a level of protection for insurance or reinsurance consumers that is substantially equivalent to the level of protection achieved under State insurance or reinsurance regulation." Dodd-Frank does contemplate that in particular circumstances a covered agreement can result in federal pre-emption of state law. Given this significant power, NAMIC urges that the USTR and the Department of the Treasury exercise their negotiating authority only if they determine that extreme circumstances demand it, and then only after full and transparent due process, including consultation with state legislative and regulatory authorities, approval by Congress, and public hearings and comment procedures. If a covered agreement is going to preempt state laws enacted through a deliberative legislative process then it should do so only following an equally deliberative process. However, it would be ideal if circumstances never give rise to the need for a covered agreement.

At this time, NAMIC does not believe that the treatment of reinsurance collateral at the state level requires a covered agreement. The National Association of Insurance Commissioners ("NAIC") and state legislatures/regulators have taken significant action on reinsurance collateral requirements since the financial crisis and since the adoption of Dodd-Frank to address perceived differences in treatment between domestic and foreign reinsurance companies. In 2011, the NAIC adopted changes to its Credit for Reinsurance Model Act and Regulation to effectuate reinsurance regulatory modernization and change foreign reinsurer collateral requirements. More than 30 states, representing more than 65 percent of the market, have adopted the revised NAIC model act and regulations.

The state implementation process should be allowed to continue without interruption by trade negotiations with the European Union. At this point, initiating a new covered agreement effort is superfluous and will not provide the same open and transparent interaction that has already been incorporated into the NAIC model and state law adoptions. The possibility of other issues being included in a covered agreement also raises risks.

If circumstances do develop that require the U.S. Treasury and the USTR to move forward with negotiations for a covered agreement, at the very least they should institute a clear, transparent procedure for the agreement. At a minimum, U.S. negotiators should publicly define the goals of the agreement and identify the benefits to the U.S. market, as is done for trade agreements. Treasury and the USTR should, as is also the case for trade agreements, consult with Congress on the scope of the negotiations, and provide the Congressional committees of jurisdiction all U.S. negotiating proposals. We also urge Treasury and USTR to consult with industry advisors on ITAC-10 and on FACI. Additionally, there should be an opportunity for interested parties and members of Congress to review the language of a final agreement before it is signed. An open and transparent process will allow legislators, regulators, and stakeholders the opportunity to raise concerns and point out any potential unintended consequences. Robust due process will help to ensure that all stakeholders, including lawmakers and the public, understand the issues and are confident that any agreement signed by the U.S. does not harm the insurance market.

The state process can be difficult to navigate at times, but it is a part of a system that has successfully protected policyholders for 150 years and helped the property/casualty insurance industry weather the recent financial crisis. NAMIC remains concerned with the use of an international trade negotiation process to alter, preempt, or create external pressures to change that system.[1]

Expansion of the Liability Risk Retention Act

The Liability Risk Retention Act ("LRRA"), enacted in the 1980s in response to a liability insurance crisis, effectively preempted state insurance laws and provided for the creation of risk retention groups ("RRGs") to provide coverage in all U.S. jurisdictions. The LRRA currently permits RRGs to underwrite commercial lines liability coverage, excluding workers' compensation, and does not apply to personal lines coverage. Under the Act, risk retention groups that meet certain licensing requirements of one state may operate nationwide. Except for the RRG's chartering state, the risk retention group is exempt from any state law, rule, or regulation that regulates or makes an RRG unlawful (with certain exceptions, including compliance with fraudulent trade practices regulations, nondiscrimination, unfair claim settlement practices, and participation in state guaranty funds).

Recently, we have seen legislative proposals to expand the application of RRGs to all forms of commercial insurance other than group health, life, disability, or workers'

[1] We note that this same basic concern exists with respect to IAIS discussions for an international insurance capital standard for internationally active insurance groups. Specifically, the IAIS focus on a quantitative group wide capital standard for IAIGs differs significantly from the current U.S. approach to supervision of large insurance groups. U.S. representatives to the IAIS should be ensuring that the international standards reflect or accommodate the U.S. approach – and not encouraging the development of standards that would require fundamental changes to our current system for the U.S. to comply, or make us an international outlier if we do not.

compensation insurance. In NAMIC's view, this legislation is a solution in search of a problem. Current market conditions do not warrant a national and permanent expansion of RRGs into property or other non-liability insurance. The admitted market is fully capable of providing this coverage. Expansion at this time is unnecessary to address any crisis in availability and affordability that would override the fundamental principles of regulatory fairness.

The insurance industry has long supported and advocated for a marketplace predicated on principles of open competition. Inherent in an effective open competition model, however, are the bedrock principles of fair competition. Fair competition demands a regulatory environment that ensures that all businesses – large, medium and small – can operate according to the same set of clearly defined rules and standards. Unless competing parties abide by the same rules, competition becomes artificial and unbalanced. Application of competition and regulatory principles in a manner that does not discriminate between or among economic entities in like circumstances and providing like goods and services is essential to a healthy, vibrant and competitive marketplace. Allowing RRG's to provide additional coverages that are readily available in the marketplace under a less stringent regulatory structure would put them on an unequal footing with conventionally formed insurers without substantial need to justify this exceptional arrangement.

The Government Accountability Office studied risk retention groups in both 2005 and 2011 at the request of the House Financial Services Committee. According to the 2011 GAO report on RRGs, state insurance regulators have expressed concerns about the capitalization and solvency of some RRGs. State regulators said that the affordability of rates offered by RRGs has not been determined, as RRGs are not required to file their premium rates with non-domiciliary state regulators. RRGs serve an important role in the insurance marketplace. However, we believe the proposed expansion is problematic and should not be approved at this time. Rather, NAMIC believes the entire insurance industry would be better served by focusing on competitive market reforms for all types of carriers across all lines, instead of by targeting a select group for preferential regulatory treatment.

The proposed legislation, by establishing separate and unequal regulatory standards based on the corporate structure of the provider, does not meet the consistency and equality standards necessary to ensure fair competition. NAMIC, therefore, opposes the expansion of the Liability Risk Retention Act.

Data Collection by the Federal Insurance Office

Dodd-Frank created the Federal Insurance Office ("FIO") to serve as a source of expertise on insurance matters for the federal government – the new office was never intended to serve as an overseer or regulator of the insurance industry. Although statutorily required to attempt to secure any data it needs from publicly available sources, within the last year, the FIO has begun two different processes by which they will be seeking to collect data directly from insurance companies.

The first set of data which will be sought is information regarding the terrorism risk insurance market in the U.S. Unfortunately the legislation passed at the beginning of 2015 to reauthorize the Terrorism Risk Insurance Act ("TRIA") included a new requirement for FIO to collect and analyze data - Section 111 - which requires the FIO to produce an annual report on the terrorism insurance market beginning in 2016 and authorizes the office to collect any data necessary that it cannot find in publicly available sources. The purpose of the study is to "analyze the effectiveness" of the TRIA program, but all that was done was to create a new study that is likely to yield results of limited value while creating a host of new costs to both industry and taxpayers.

Specifically, the study is supposed to contain information regarding:

- Lines of insurance with exposure to such losses;
- Premiums earned on such coverage;
- Geographical location of exposures;
- Pricing of such coverage;
- Take-up rate for such coverage;
- Amount of private reinsurance purchased for acts of terrorism; and
- Other matters as the Treasury secretary considers appropriate.

To its credit, the FIO has been actively seeking feedback from stakeholders, both in individual meetings and during broader meetings hosted at the Treasury Department. It is clear the office is attempting to understand the challenges inherent in producing data that may not be readily available or easy to isolate. NAMIC appreciates the difficult task before the FIO and is seeking constructive ways to assist the office in obtaining useful information.

One key concern with the TRIA data collection process has been the lack of coordination between the FIO and state regulators. Ideally, the FIO would not need to conduct any data calls and would be able to instead collect data from state regulators or other statistical aggregators. Once the relevant data to be collected is determined, it is imperative that insurers not be forced to comply with multiple, varying, and potentially costly data calls simply because coordination could not be achieved.

The second potential data call deals with a statutory mandate under Dodd-Frank that requires the FIO to monitor the extent to which traditionally underserved communities and consumers, minorities, and low- and moderate-income persons have access to affordable insurance products of all lines, except health insurance. It was decided that auto insurance would be the first line of insurance to be analyzed and that an official study and report would subsequently be produced.

In May of 2014 FIO solicited feedback from state insurance regulators, consumer organizations, insurance industry representatives, policyholders, academia, and others on "both a reasonable and meaningful definition of affordability and the metrics and data that it should use to monitor availability and affordability of auto insurance." In comments submitted the to the FIO in June 2014, NAMIC highlighted the difficulty of defining "affordability" as it is an inherently subjective term and recommended that rather than inventing a definition, the office should use consumer expenditure data to consider the relative cost of other goods and services. In its comments, NAMIC also took the opportunity to remind the FIO that accurately matching price to risk is imperative to the business of insurance, and that this principle not be subverted by policymakers in the name of affordability.

Having already solicited ideas about how to define affordability, on July 1 of this year the FIO again sought comments from state insurance regulators, consumer organizations, insurance industry representatives, policyholders, academia, and others on a proposed working definition. In the notice, the FIO laid out a working definition of what qualifies a personal auto liability insurance policy as affordable. The definition suggests a policy is affordable if annual premiums are within the financial means of individuals, as measured by an affordability index, the make-up of which was also proposed in the notice. Specifically, the office proposed that auto liability insurance is affordable if, with respect to household income, the affordability index does not exceed two percent for affected individuals.

As expected, this attempt to firmly define affordability in the context of auto insurance resulted in a confusing and unhelpful product. Of particular concern about the FIO's proposed definition was that it would have the effect of dismissing as irrelevant all existing government sources of auto insurance expenditure data. If so defined, it would likely require the FIO to conduct an expensive and time-consuming data call despite the fact that there is significant amounts and sources of publicly available data that could be used if affordability is properly defined.

As constituted, this proposed definition could lead the FIO to engage in a costly data call with its own limited resources and at the great and unnecessary expense of insurance consumers. However, to be clear, Dodd-Frank does not require the FIO to issue data calls on private entities. To the contrary, the expectation is that the FIO will "monitor" and first utilize and analyze existing sources, including the vast data and studies already available through the states, the NAIC and other sources. Given the flexibility the FIO has under the enabling law, NAMIC is concerned that the office is seeking to define its task in such a way as to leave itself no choice but to collect data in this area.

NAMIC urges the committee to continue to monitor these ongoing data collection efforts and if needed, consider legislation to provide a correction to our current course to ensure the FIO is not conducting unnecessary data calls that would serve to make products more costly for consumers.

HUD's Disparate Impact Rule

On November 16, 2011, the Department of Housing and Urban Development ("HUD") proposed significant changes in the implementation of the Discriminatory Effects Standard in the Fair Housing Act ("FHA"), which prohibits discrimination against any person in "the terms, conditions, or privileges of sale or rental of a dwelling, or in the provision of services or facilities in connection therewith, because of race, color, religion, sex, familial status, or national origin." The rule sought to clarify existing standards for determining when a housing practice with a discriminatory effect violated the FHA and clarify liability standards where a facially neutral housing practice has a prohibited discriminatory effect.

On February 8, 2013, HUD issued a final rule which codifies the use of "disparate impact" analysis to prove allegations of unlawful discrimination with regards to homeowners insurance. This means that any factor used by insurers to assess risk could be challenged if it produces statistically disproportionate outcomes among particular demographic groups. The rule will apply in situations where there was no intent to illegally discriminate, and where all policyholders and applicants for insurance were subjected to the same underwriting and pricing criteria without regard to race, ethnicity, or any other prohibited characteristic. It is also important to note that unfair discrimination issues relating to insurance have traditionally been addressed by state regulators, as federal law establishes insurance regulation under the jurisdiction of the states.

In theory, any insurance underwriting factor could be threatened by the application of a disparate impact standard. Therefore, the property/casualty insurance industry rightly saw this final rule as a direct threat to the business of insurance. For that reason, NAMIC and the American Insurance Association ("AIA") filed a legal challenge in February 2014 in the Federal District Court of Washington D.C., alleging that a disparate impact standard of discrimination was not cognizable under the FHA. In late 2014, NAMIC and AIA won the case and HUD's rule was vacated.

Although HUD appealed the decision, the case was stayed while the Supreme Court heard the case of the Texas Department of Housing and Community Affairs v. The Inclusive Communities Project, Inc. The Supreme Court heard arguments in the case in early 2015. On June 25, 2015, the Supreme Court, in a surprise five-to-four decision upheld the application of disparate impact under the FHA. Of particular surprise was that the Court created FHA authorization for disparate impact, even though the term "disparate impact" is not found anywhere in the statutory language of the FHA. In rather tortured reasoning and verbal gymnastics, the Court ruled that Congress wanted disparate impact in the FHA - despite the fact that they never said so - because disparate impact is "consistent with the FHA's central purpose."

The Court did describe the specific safeguards necessary "to protect potential defendants against abusive disparate-impact claims." For example, the Court held that a "racial imbalance does not, without further evidence, establish a *prima facie* case of disparate impact," and that a plaintiff can no longer maintain a disparate-impact claim by pleading a mere "statistical disparity." Further, the justices made clear that "policies are not contrary to the disparate-impact requirement unless they are artificial, arbitrary, and unnecessary barriers." In sum, the Court required significant limitations on the application of the theory, and very important safeguards for defendants.

It is NAMIC's view that the requirements and limitations set by the Court are not included in, and in fact run contrary to, the HUD description of the theory contained in its 2013 disparate-impact rule. Congress should conduct strict oversight of HUD and make clear that abuse of the disparate impact standard will not be tolerated.

National Association of Registered Agents and Brokers

The National Association of Registered Agents and Brokers Reform Act ("NARAB") established an independent body that agents who sell insurance in multiple states are eligible to join. A NARAB member would be authorized to sell, solicit, or negotiate insurance and perform related activities in any state where the producer seeks to operate, if the member pays the requisite state-established licensing fees and is duly licensed in his/her home state. NAMIC has long-supported the NARAB initiative and joined with others in the industry to help usher the legislation through Congress as part of the same legislation which reauthorized the Terrorism Risk Insurance Program in the beginning of 2015.

The law requires that NARAB be up and running within two years following enactment, which was January 12, 2015. The next step is for the president to appoint a board of directors - to be approved by the Senate - within 90 days, a deadline that has obviously been missed. The 13-member board will be comprised of eight state insurance commissioners, three individuals with "demonstrated expertise and experience with property and casualty insurance producer licensing," and two individuals with similar expertise and experience in the life or health insurance arena. The board of directors is required to have its first organizational meeting within 45 days of being appointed.

NAMIC encourages the committee to help push the administration to finish the appointment process in a timely manner so that the implementation of NARAB can continue.

Natural Catastrophe Mitigation

Federal disaster declarations and disaster spending aid have skyrocketed in recent years. According to the Federal Emergency Management Agency, federal major disaster declarations have jumped from a yearly average of 23 under President Reagan to an average of 65 under President Obama; and since 2011, $137 billion has been spent on federal funding for disaster relief – roughly $400 per household annually. Severe weather events regularly occur in every state of the country in every month of the year. These include winter storms, thunderstorms, tornadoes and hail, tropical cyclones, extreme temperature fluctuations, and droughts.

As the costs of storms continue to grow so does the federal government's exposure - and ultimately the taxpayer's - covering the difference between insured and uninsured losses through emergency allocations. For instance, when Hurricane Diane struck the Atlantic coast in 1955, the federal government was responsible for five percent of total losses. Fast forward to the fall of 2005, after Hurricane Katrina hit the Gulf coast, the federal government took responsibility for approximately 50 percent; and when Hurricane Sandy made landfall in October of 2012, the federal government covered approximately 80 percent of all losses. Our current disaster policy has led us down an unsustainable path, with emotionally-charged supplemental emergency allocations (over $60 billion for Super Storm Sandy alone) directly increasing the national debt, and resulting in very ineffective, inefficient, and unaccountable spending.

NAMIC and the industry have long been advocates of using mitigation to prevent losses from natural disasters, which has been proven to greatly reduce the level of property damage and human suffering caused by these disasters. In 2011, recognizing the vision of many different outside stakeholders, NAMIC launched the BuildStrong Coalition which has continued to expand and is now comprised of insurers, emergency managers, builders and contractors, engineers, architects, fire fighters, and code officials who all share the commitment to developing a national mitigation strategy that incentivizes states, businesses and consumers to build stronger and safer. NAMIC, and the BuildStrong Coalition, believe it's time for America to establish a comprehensive national disaster mitigation strategy comprised of common-sense mitigation measures to enhance the nation's current infrastructure and strengthen preparedness for natural disasters.

Although NAMIC believes a paradigm shift in the way the federal government approaches disaster spending is needed, there are a variety of common-sense mitigation measures that Congress could implement in the near term that would help to build a more resilient nation.

The Safe Building Code Incentive Act, H.R. 1748
Studies have shown that building codes are the most effective mitigation measure and can greatly reduce damage from severe weather events. The Safe Building Code Incentive Act would increase the amount of federal monies available to a state under current disaster relief legislation by four percent if that state adopted and enforced nationally recognized building code standards. Over time, with states building to a higher building standard, losses from disasters would decrease, reducing the overall burden on the taxpayer.

National Windstorm Impact Reduction Act Reauthorization of 2015, H.R. 23
The bill amends the National Windstorm Impact Reduction Act of 2004 to revise provisions governing the National Windstorm Impact Reduction Program ("NWIRP").

It changes the designation to the National Institute of Standards and Technology as the entity with primary responsibility for Program planning and coordination. The objective of NWIRP is to achieve measurable reductions in losses of life and property from windstorms by improving our understanding of how wind impacts buildings, enhancing the scope and detail of damage data collection, and measuring the degree to which varying mitigation techniques can lessen that impact.

NAMIC commends the House and the Senate for recently passing this important legislation and sending it to the president for his signature.

The Disaster Savings Account Act, H.R. 2230
This bill would allow eligible individuals to deduct up to $5,000 contributed to a designated "disaster savings account." An eligible individual is defined as any individual who owns a home in the U.S. that is insured. A disaster savings account would be a trust created in the U.S. exclusively for the purpose of paying disaster mitigation expenses of the trust's beneficiary.

This bill would incentivize individuals to take measures into their own hands and retrofit their homes pre-disaster.

The Disaster Savings and Resilient Construction Act of 2015, H.R. 3397
The bill was introduced in late July and would provide a tax credit for a portion of the cost of qualified residential and commercial property that meet the 2009 or later International Code Council Standards, has received the designation of FORTIFIED for Safer Living/Business from the Institute for Business and Home Safety, and was constructed within three years following the occurrence of a disaster. In the case of qualified residential property, homeowners can receive up to a $3,000 credit, and for qualified commercial property, business owners can receive up to $25,000.

As with the Safe Building Code Incentive Act and the Disaster Savings Account Act, the Disaster Savings and Resilient Construction Act, without issuing a mandate or creating a federal backstop, encourages home and business owners to take responsible steps before a disaster strikes.

Conclusion

Congress has a critically important role to play in fostering an environment in which the property/casualty insurance industry can continue to thrive for the ultimate benefit of our economy and society. Through prudent oversight and awareness, along with the possible enactment of legislation to facilitate a needed course correction if necessary, lawmakers can help protect the robustly competitive insurance market in the U.S., and thereby protect consumers, policyholders, and taxpayers.

PCI
Property Casualty Insurers Association of America
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STATEMENT OF PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA

U.S. HOUSE FINANCIAL SERVICES COMMITTEE

ON

"The Impact of Domestic Regulatory Standards on the U.S. Insurance Market"

September 29, 2015

I. Introduction

Chairman Luetkemeyer, Ranking Member Cleaver and members of the subcommittee, the Property and Casualty Insurers Association of America (PCI) commends you for holding this important hearing on "The Impact of Domestic Regulatory Standards on the Competitiveness of U.S. Insurers" and appreciates the opportunity to provide testimony. PCI represents nearly 1000 insurers and reinsurers that provide virtually every type of coverage in the U.S. and around the globe. Our member companies include large, medium and small companies that through us work cooperatively with legislators and regulators to, as written in our mission statement, "promote and protect the viability of a competitive private insurance market for the benefit of consumers and insurers."

PCI appreciates the leadership your subcommittee has shown in supporting the policy enunciated in the McCarran-Ferguson Act that the business of insurance should continue to be regulated by state insurance regulators who are most focused on protecting U.S. consumers and competitiveness. Now that the Dodd-Frank Act has established additional federal involvement in insurance, through limited roles by the Federal Reserve Board and the Treasury, your subcommittee is playing a helpful role in examining whether their involvement and new domestic or international insurance standards they are committing to will ultimately improve the competitiveness of the U.S. insurers and the marketplace.

The current U.S. regulatory system has produced the strongest, most competitive and largest insurance market in the world. While the U.S. share of the global banking market has hovered around 11-13%, roughly one-third of the world's insurance premiums come from the U.S. and nearly half of the 50 largest insurance markets in the world are U.S. states. Over the past several years the property-casualty insurance industry has established record surplus and exceptionally low leveraging to safely support policyholder needs, and even in the depth of the recent financial crisis property-casualty insurance firms had very few insolvencies and outperformed the broader stock market in recognition of the financial safety of the industry.

Despite the exceptionally strong record of insurance regulatory success, the Federal Reserve, Treasury and state regulators have been under enormous domestic and international pressure to develop new holding company regulations. Congress with enactment of the Collins Amendment clarified its views that bank regulatory standards were not appropriate for insurance. The Fed, Treasury and state regulators remain deeply engaged in negotiating international efforts to consider imposing a global capital standard for insurance, which may not be appropriately designed for the business of insurance, particularly for U.S. insurers and some of the products they offer.

PCI recommends to the Committee's attention expert research papers by Drake University's Terri M. Vaughan and Cato Institute's Mark A. Calabria and Dr. Robert Shapiro, detailing the potential risks and monetary costs to U.S. consumers of a Basel/Solvency II bank-like regulatory system. Dr. Shapiro's study, "Unnecessary Injury: The Economic Costs of Imposing New Global Capital Requirements on Large U.S. Property and Casualty Insurers" for Sonecon, found that imposing Solvency II type capital standards on large internationally active US insurers would add nearly $100 every year to every home owner's insurance policy our consumers purchase. The Vaughan-Calabria study, "International Developments in the Insurance Sector: the Road to Financial Instability?" concluded that bank centric international standards might actually destabilize well-functioning insurance markets and actually create system risk by driving all insurers to adopting the same business models.

It is particularly critical for our U.S. representatives to the international agencies that are dictating financial policy to oppose new supervisory standards if they are not necessary and appropriate and in any event before the Federal Reserve has adopted appropriate risk measurements for the holding companies it supervises, which should be strongly tied to the proven existing state risk-based capital regime. Otherwise, instead of leading productive discussions towards mutual recognition of the U.S. system, our regulators and companies will be prejudiced by a harmful and potentially discriminatory global standard.

Congress has an essential and time sensitive role to play to buttress our U.S. state and consumer based regulatory system. Congressional oversight and legislation is both necessary and helpful to achieving coordination and consensus among the government entities involved, clarification of purpose and focus on consumers, and appropriate transparency and accountability in our domestic and international insurance engagements. The Subcommittee and full Committee have held a number of helpful hearings and several members of the House and Senate have introduced legislation that could potentially be very helpful. PCI urges strong action by the Committee on these issues.

II. The International Pressures Driving Changes in U.S. Insurance Regulation

Henry Ford once said "Any customer can have a car painted any color that he wants so long as it is black." The same one-size-fits-all philosophy is now being applied on a global basis to the insurance market with attempts to force all financial regulation into a bank-like system, losing the balance of consumer protection and competitive markets.

The focus on bank holding company regulation emanates from the Financial Stability Board (FSB). The FSB was based on an ad hoc body of central bankers, founded in 1999. During the financial crisis, the G-20 finance ministers and central bank governors formalized it and gave it nearly unlimited policy-making authority over all financial services, including insurance, without the benefit of Congressional debate or adequate transparency along the lines of what is required in the U.S. (e.g. open meetings and adherence to meaningful administrative procedures in the development and adoption of rules). Specifically, members of the FSB commit to "implement international financial standards" including "Insurance Core Principles, Standards, Guidance and Assessment Methodology." The FSB is chaired by a central bank, located in the Bank for International Settlements, composed primarily of central banks and finance ministers, and conducts its meetings largely behind closed doors. There is only one insurance specific member of the FSB (out of 70 members) – the International Association of Insurance Supervisors (IAIS), which itself is governed in part by numerous banking regulators. The US delegation to the FSB does not include any insurance regulators.

The FSB has exercised its self-generated authority across the entire length and breadth of insurance regulation. Under its leadership, the International Accounting Standards Board (IASB) has attempted to impose a mark to market international insurance accounting standard on the rest of the world (wisely rejected by the U.S.

Financial Accounting Standards Board), despite global market complaints about excessive costs and inefficiencies and the danger of increasing volatility and "short termism" even as it discourages much needed investment in infrastructure. The FSB has decided which bank and insurance companies had to be designated as systemically important (decisions that were subsequently implemented in the U.S. over the objection of domestic insurance experts and regulators). And the FSB has demanded adoption of increased central regulation of insurance with global capital requirements and a one-size-fits-all set of principles for resolution of financial entities, despite very different realities among the sectors.

The other largest insurance market in the world, Europe, responded to the financial crisis by approving Solvency II, a new regulatory system for insurers based in large part on the Basel international banking standards. While including numerous improvements over Solvency I, the new system is costing the insurance marketplace hundreds of millions of dollars to retool. Reflecting differences in the European and U.S. marketplaces and regulatory systems, Solvency II is heavily based on the use of capital to address regulatory concerns, and is focused at the top of the group to protect investors. For example, many European countries do not have comprehensive guaranty funds to protect policyholders and are more likely to have national champions with extensive activities, resulting in a greater focus on the need for additional capital to avoid the consequences of insolvencies.

Important European voices are questioning some aspects of Solvency II as it has evolved. Top among the contentious issues is the focus on mark-to-market accounting and the high levels of capitalization that some supervisors are requiring.

While Solvency II was still being developed, its group level and capital focus were migrated to global standards through the IAIS. Thus the global standards are largely a generic version of Solvency II. This poses a significant challenge to the U.S. which has a very different history, market context and regulatory system. Accordingly, most U.S. insurers and state regulators prefer mutual recognition of the best regulatory systems (including the U.S.) rather than mandating a single global regulatory model, especially if that model is based on another system that is significantly different from ours.

Current Priority Issues Arising Out of International Developments

Higher Loss Absorbency (HLA)

The International Association of Insurance Supervisors (IAIS) has committed to adopting strict holding company capital requirements (HLA) for systemically important insurers for the G-20 to approve by November 2015. And we note that the FSB has just approved an IAIS proposal. This is premature and could have very negative consequences for the companies subject to the HLA, along with consumers and markets.

There are many reasons why it is important to take more time on this issue. First, there is no global consensus on the formula or approach. Second, key definitions have not been agreed to, including what constitutes Non-Traditional/Non-Insurance (NTNI) activities. Third, the relationship to other capital standards is unclear. And fourth, imposing an unnecessary new capital mandate on some companies artificially creates competitive imbalances. It is critical for the Federal Reserve to complete development of its domestic standards for insurance holding companies it supervises before global commitments are made on an HLA. For all of these reasons, PCI believes that Congress should direct our U.S. representatives to the IAIS and FSB to oppose finalization of the HLA standards pending the successful resolution of a number of these fundamental issues.

Lack of Transparency and Exclusion of Key U.S. Players and Interested Parties

The FSB is increasingly the international locus of decision-making on all financial services regulatory issues. Yet the state regulators are not represented and insurance regulators over-all are under-represented at the FSB. The FSB makes its decisions behind closed doors and there is little if any consultation with the Congress or interested parties by U.S. delegation members before they advocate a position.

The IAIS, mimicking FSB procedures, recently voted to exclude interested parties from working group meetings, thereby restricting meaningful access by U.S. companies and consumers. This vote was taken with the approval of Treasury's FIO but against the votes of the NAIC and state regulators. The IAIS' new closed door procedures are out of step with the current trend toward greater transparency and with the procedures used by the NAIC where interested parties can observe and usually participate in working group and other meetings. PCI believes that all U.S. representatives should insist that transparency similar to that of the NAIC must be the rule in international forums considering insurance regulatory standards.

III. The Importance of Getting Our Domestic Standards Right

U.S. Capital Standards

In the congressional hearings and public forums leading to the enactment of the Insurance Capital Standards Clarification Act of 2014, an oft-repeated theme was that regulators should avoid using a one-size-fits-all approach to setting capital rules for financial companies under its jurisdiction. This was most typically reflected in the view that insurance companies should not be regulated like banks and subject to rules designed for banking.

There is significant international pressure to create a global capital standard for large internationally active insurers. If such a standard is appropriate and necessary, and many doubt that it is for the U.S. It is critical that the Federal Reserve and NAIC be allowed the time to get it right domestically so that the U.S. can lead international efforts towards mutual recognition. If international standards precede domestic standards, at best they create uncertainty and transition costs for impacted insurers while at worst they will establish harmful and anticompetitive regulatory burdens that will directly or indirectly pressure and influence a suboptimal domestic compromise.

PCI believes that the public is best served by proposals with the least additional cost, burden and complication when compared with the proven effective state-based standards in place today. No regulator has made a strong case or provided any consumer-focused cost-benefit analysis as to why direct holding company regulation is necessary for insurance companies, particularly when there is no source of strength doctrine applicable to insurance nor any possibility of a run on insurance companies.

However, to the extent that a domestic or international group capital measurement is established, state insurance regulators and PCI members strongly believe that the most efficient, effective and time-tested approach should be to aggregate existing state developed risk-based capital requirements for the legal entities. U.S. insurance risk-based capital (RBC) standards have been proven effective through many real world stress tests, including the financial crisis.

Last week, the NAIC's ComFrame Development and Analysis (G) Working Group decided unanimously to recommend that the NAIC develop a group capital calculation using the "RBC Aggregation Approach". PCI and the overwhelming majority of the U.S. industry support in concept the aggregation approach, as opposed to, for example, alternative statutory accounting consolidation or GAAP consolidation approaches. The Federal Reserve is similarly considering various alternative approaches. It is critical that the Federal Reserve coordinate its approach appropriately with the states and consider the similar costs and benefits in its analysis, and that our U.S. representatives to the IAIS and FSB do not prematurely allow a global commitment to a conflicting HLA or ICS standard.

In addition, PCI suggests that any Federal supervision of insurance holding companies should be proportional to their risks to federal deposit insurance (in the case of insurance savings and loan holding companies) or their specifically identified systemic activities (in the case of SIFIs). PCI has had numerous insurance company members subject to Federal Reserve oversight divest their thrifts because by their calculation the cost of Federal Reserve oversight far outweighed any benefit that was being provided to consumers. Regulatory costs may decrease as the Board grows its insurance expertise and focuses its efforts. But policymakers have an appropriate role in clarifying the desired balance between trying to regulate for every possibility of failure versus facilitating a competitive and cost-efficient marketplace with a very strong safety net for consumers.

PCI believes that for the companies it regulates, the FRB should have the time it needs to do its work in collaboration with state regulators, which the end result should be an aggregation approach with the minimum change and that international standards should be delayed until that is done.

Designation and Regulation of Systemically Important Insurers (SIFIs)

The Dodd-Frank Act set forth a list of factors the FSOC is to consider when determining whether a nonbank is systemically important. However, FSOC's designation decisions regarding insurance groups has not provided a meaningful analysis of these factors, focusing instead primarily on issues relating to the size of the company and on hypothetical and arguably implausible scenarios under which material financial stress at the company would pose systemic risk to the economy. By declining to address the statutory systemic risk factors, the FSOC's designation decisions have not clearly established a coherent rationale for the decision based on activities in which the firm engages. This does not foster confidence in the FSOC's decisions. It also leaves all companies in the dark about what activities the FSOC considers systemically risky and thus provides no clear direction to companies on how to reduce systemic risk.

The Government Accountability Office (GAO), in a report released on November 20, 2014, also criticized FSOC for "using only one of two statutory determination standards (a company's financial distress, not its activities)" and noted that "FSOC may not be able to comprehensively ensure that it had identified and designated all companies that may pose a threat to U.S. financial stability."

FSOC's failure to address the ten specific "considerations" set forth in Dodd-Frank is particularly problematic with respect to recent insurer designations. One of those factors is the degree to which the company is already regulated by one or more primary financial regulatory agencies. State insurance regulation has a long-established, excellent record of protecting consumers against insurance insolvencies. Indeed, it could well be argued that its record is superior to that of numerous federal regulators who have regulated banks, savings and loans, and other financial firms. Despite this, the designations seem to assume that state insurance regulators would be unable or unwilling to respond effectively to problems in insurance companies. For example, the FSOC worried that financial troubles at a life insurer could lead policyholders to seek to surrender their policies in a disorderly manner, but the FSOC failed to acknowledge that state insurance regulators have the ability to impose stays or take other action to manage any such surrender activity. Congress recognized that state regulators have a number of options to mitigate systemic risk, but the FSOC has disregarded those tools. In exercising its oversight responsibilities, Congress should reaffirm its instruction that FSOC consider and provide an in-depth analysis of each of these factors in determining whether an insurer should be designated as systemically important.

FSOC's decisions to designate insurers as systemically important are particularly disturbing given that the decisions with regard to two were reached over the strong and substantive objections of both FSOC's

Independent Member Having Insurance Expertise and the non-voting State Insurance Commissioner Representative. The FSOC's decision record does not make clear why the strong views of these two insurance experts were disregarded and provides no substantive refutation to the informed and well-reasoned arguments of these experts. We view this as one of the surest signs that the FSOC designation process is flawed and in need of increased congressional oversight and reform. At a minimum, Congress should consider directing the FSOC to provide a well-articulated and substantive discussion of its rationale any time it disregards the expert advice of those on the FSOC who Congress put there to bring insurance expertise to the table.

A byproduct of the lack of clear rationales for FSOC designation decisions is that the FSOC has not provided a roadmap for how companies can take action to eliminate activities that pose systemic risk and thus become eligible to have a designation of systemic importance removed. The ultimate goal of the Dodd-Frank Act was to reduce systemic risk and it created the FSOC primarily to do so. By failing to specifically identify the systemically risky activities required to be addressed in companies it designates or to provide an "exit ramp" for such companies, the FSOC replaces an effort to reduce systemic risk with just another layer of federal control.

The FSB has now indicated that it will be considering additional insurers to designate as systemically important and has demanded that the IAIS change its systemic risk analysis accordingly. PCI believes that the U.S. SIFI designation process should be overhauled to be decoupled from any international process and to be more transparent, to provide deference on insurance issues to the insurance experts and to clearly provide for an exit ramp.

IV. <u>Other Important Insurance Issues Before the House Financial Services Committee</u>

<u>HUD/disparate Impact</u>

The Department of Housing and Urban Development issued a rule implementing disparate impact test on housing activities, specifically including homeowners insurance. McCarran Ferguson applies to federal agencies and HUD's incursion into state regulation will conflict, impair or supersede the laws and regulations established by states to protect consumers. Recently, the Supreme Court upheld the disparate impact test as a basis for liability under the Fair Housing Act. A federal district court, at PCI's request, remanded HUD's rule finding it is arbitrary and capricious under the Administrative Procedures Act partly on the basis that HUD failed to consider McCarran Ferguson. Imposition of HUD's rule could have significant negative consequences for domestic insurance markets and consumers.

<u>Federal Data Collection</u>

Various federal agencies subject to the Committee's jurisdiction have been amassing vast quantities of consumer transactional financial data. Some groups have been advocating that the Federal Insurance Office (FIO) in Treasury start imposing data calls on the insurance industry, particularly in the context of auto insurance and terrorism insurance. The Dodd-Frank Act and TRIA require FIO to first obtain data from the states and public sources where reasonably available before imposing new costs on insurers. Insurers are also very concerned about federal data security as this often sensitive consumer information is amassed. The federal government has had numerous known data breaches compromising personal information. PCI encourages Congress to work with the federal agencies to minimize the number and costs of data calls, ensure that data demands are coordinated with the states or appropriate data aggregators that can keep information confidential, and to avoid collection of any personally identifiable information.

Data Security

PCI strongly supports consideration by the Committee of national preemptive standards on data security and breach notification. PCI appreciates the current Committee consideration of expansion of the Gramm-Leach-Bliley Act functional regulator enforcement with an appropriate standard of actual harm. PCI has suggested some technical improvements, as well as focusing insurance enforcement through insurers' lead state regulator for consistency.

Raiding Insurers to Protect Banks

Bipartisan members of the Committee have introduced legislation supported by state insurance regulators to limit the ability of federal banking regulators to access insurer assets as a source of strength for banks, potentially robbing assets dedicated to insurance consumers to satisfy bank creditor demands. The legislation also makes a technical correction to the DFA regarding state insurance regulators' ability to rehabilitate insolvent insurers. PCI strongly supports this bipartisan legislation.

Allowing Lenders to Accept Private Flood Insurance

The Ross-Murphy Act (H.R. 2901) would clarify a provision in Biggert-Waters designed to provide consumers with a choice to purchase private flood insurance coverage and reduce lender reliance on federal flood coverage. PCI believes this is an important step in the right direction.

NARAB

The Administration is currently vetting potential nominations for the board of the National Association of Registered Agents and Brokers (NARAB) that Congress authorized earlier this year. NARAB would allow nationwide licensing for insurance providers with substantial state regulator control. PCI looks forward to working with policymakers to successfully get NARAB up and running.

Equivalence and Covered Agreements

The European Union has signaled its interest in providing temporary equivalence to the United States and our U.S. insurers under its Solvency II requirements in return for certain concessions in a covered agreement on foreign reinsurance collateral requirements. PCI expressed our views to the U.S. agencies involved regarding the importance of preventing discrimination against U.S. insurers, the potential danger spots in such an agreement including preemption of state regulation, and the need to coordinate with the state insurance regulators to achieve reasonable consensus on any regulatory changes that will required.

V. Conclusion: Congress Should Re-establish Its Policymaking Role in Support of the U.S. System to Ensure Prioritization of Consumers and Competition

As international and domestic regulatory developments gain in urgency and importance, it is vitally important that Congress re-establish its ultimate decision-making authority. Here are some critically needed actions by the Congress:

- Clarify the need for increased transparency and consultation with Congress and for all U.S. players to advocate international standards that are sufficiently flexible so as to recognize U.S. regulation by the Federal Reserve and states as at least one way to comply with the international standards;
- Clarify that the FSOC process needs reform including more transparency and an exit ramp;
- Evaluate the necessity and appropriateness of the need for any new and higher capital standards for U.S. insurers;
- Delay international capital standards, most immediately the HLA, until the U.S. has developed its approach;
- Make clear that all U.S. representatives need to work together to support least burdensome new standards in areas such as capital requirements (such as an RBC aggregation approach), including HLA;
- Emphasize the need to oppose standards that would have a negative effect on the U.S. markets and consumers;
- Prevent mission creep by federal agencies in terms of data collection and other regulatory functions that should remain the responsibility of the states; and
- Continue robust oversight and legislative consideration.

Several legislative proposals contain elements of these key points and we urge the Congress to enact them.

NATIONAL ASSOCIATION OF PROFESSIONAL INSURANCE AGENTS | Local Agents Serving Main Street America℠

STATEMENT BEFORE THE U.S. HOUSE OF REPRESENTATIVES COMMITTEE ON FINANCIAL SERVICES SUBCOMMITTEE ON HOUSING AND INSURANCE HEARING ON "THE IMPACT OF DOMESTIC REGULATORY STANDARDS ON THE U.S. INSURANCE MARKET." September 29, 2015

Founded in 1931, the National Association of Professional Insurance Agents (PIA) is a national trade association that represents independent insurance agencies and their employees who sell and service all kinds of insurance, but specialize in coverage of automobiles, homes and businesses. PIA represents independent insurance agents in all 50 states, Puerto Rico, and the District of Columbia. They operate cutting-edge agencies and treat their customers like neighbors, providing personal support and service. PIA members are *Local Agents Serving Main Street America℠*.

Background

By any objective measure, the U.S. insurance industry is an overwhelming success. Insurance is a broad-based risk management tool that provides for protection against loss throughout the economy. The insurance industry provides the economic stability and certainty that our entire economy needs in order to function well.

The U.S. insurance industry contributes heavily to the economy. For example, the U.S. insurance industry's net premiums written totaled $1 trillion in 2013, with premiums recorded by life/health (L/H) insurers accounting for 54 percent and premiums by property/casualty (P/C) insurers accounting for 46 percent, according to SNL Financial.[1] Insurance carriers and related activities accounted for $413.1 billion or 2.5 percent of U.S. gross domestic product (GDP) in 2012, according to the U.S. Bureau of Economic Analysis.[2] Cash and invested assets of insurance companies totaled $5 trillion in 2013, according to SNL Financial.[3]

The insurance industry is a major employer, with 2.4 million people employed in 2013, according to the U.S. Department of Labor.[4] Of those, 1.4 million worked for insurance companies and the remaining 943,200 people worked for insurance agencies, brokers and other insurance-related enterprises.[5] The U.S. insurance industry is also a major taxpayer, paying $17.4 billion in premium taxes in 2013, or $55 for every person living in the United States, according to the U.S. Department of Commerce.[6]

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[1] 2015 Insurance Fact Book, Insurance Information Institute, page v; ISBN 978-0-932387-72-1
[2] Ibid.
[3] Ibid.
[4] Ibid.
[5] Ibid.
[6] Ibid.

While the state of the insurance industry is strong, there are also challenges and issues that need to be addressed. While perhaps not contemplated at the time, the 2010 passage of the Dodd-Frank Financial Reform Act has had a profound impact on insurance regulation. Under the Dodd-Frank Act, the Financial Stability Oversight Council (FSOC) has the power to designate "systemically important financial institutions" (SIFIs). PIA has ongoing concerns regarding the level of transparency in the FSOC decision-making process and supports the important role that state-based insurance regulation plays in maintaining competitive markets and protecting consumers.

The Dodd-Frank Act also created the Federal Insurance Office (FIO), which stipulates that the FIO is not an insurance regulator. PIA agrees with this prudent restriction and believes that the FIO should have no role concerning insurance regulation.

Developments in the international insurance arena mean that U.S. negotiators must ensure the interests of the U.S. insurance industry and policyholders are of utmost importance during negotiations. Transparency and engagement with insurance stakeholders during negotiations is a vital aspect of ensuring the successful U.S. insurance industry is not adversely impacted by international agreements. It is also of great urgency that two key pieces of legislation recently signed into law—the Insurance Capital Standards Clarification Act and the National Association of Registered Agents and Brokers (NARAB)—are implemented both correctly and in a timely manner.

State-based Regulatory System

For over 150 years, the state-based system of insurance regulation has worked, successfully protecting consumers and creating a competitive and diverse U.S. insurance market. In fact, a report issued by the Government Accountability Office (GAO) in June 2013 found the state-based system of insurance regulation helped to mitigate the negative effects of the 2007-2009 financial crisis on the insurance industry.

PIA opposes any federal or international effort that would undermine the state-based system of insurance regulation, such as adopting a one-size-fits-all approach to global insurance regulation. Instead of wide-ranging national and global dictates, PIA supports coordination and cooperation between state and federal officials, along with international bodies. Cooperation can help improve the existing insurance regulatory system.

Overlapping state, federal, and international regulations would generate an additional burden on the industry, raising consumer costs with no coordinating increase in consumer protections. Recent research by Sonecon and the American Enterprise Institute found that international efforts to increase capital standards on property and casualty insurance companies are not only unnecessary, but could raise homeowners' insurance premiums by as much as 8%.

PIA supports the use of state-based tools, such as interstate compacts and model laws, which can be tailored to account for variations in the local environments in which insurance groups operate. State-based tools are a better option to protect consumers, support a dynamic local and national marketplace, and avoid market disruption than general and overarching federal or international standards.

Protecting State Insurance Regulation

PIA supports a modernized state-based insurance system and opposes any federal regulation or international standards that would destabilize or supplant state-based regulations.

While states set insurance policy and regulate insurance in the U.S., developments at the international level heavily influence state laws and regulations. Actions by certain federal and international bodies have raised alarm that the state-based insurance regulatory system may be needlessly eroded in the face of new global challenges. It is essential that federal regulation does not intrude upon the current state system. To this end, PIA has endorsed S. 798, the Policyholder Protection Act, which would better empower state insurance regulators to protect policyholders in their state by ensuring that insurance companies structured under larger financial firms are not held financially responsible for an affiliated bank's failure or financial crisis. Furthermore, S. 798 ensures that state regulators, and not the FDIC, have the power to appropriately manage a troubled insurer for the best interest of policyholders.

In addition, the Dodd-Frank Act granted the FIO authority to monitor the affordability of auto insurance as it impacts underserved communities. To that effect, the FIO has taken steps to craft a defined matrix to measure affordability; however, PIA supports state-based solutions as the best way to address auto insurance affordability. State insurance regulators have effectively protected consumers and regulated the auto insurance industry since its advent.

Transparency

The built in checks and balances of the state-based regulatory system ensure transparency and accountability. PIA believes the same standards should apply to federal offices and commissions, such as the FIO and FSOC, as well as, international organizations, such as the Financial Stability Board (FSB) and the International Association of Insurance Supervisors (IAIS). PIA opposes any federal or international actions that give rise to the appearance of impropriety or seek to limit input in the deliberative process. PIA supports efforts to increase transparency and cooperation, and to ensure that state insurance regulation is afforded appropriate deference in any federal or international decision-making process.

On Capitol Hill, PIA supported Congressional resolutions calling on the IAIS to conduct its business in an open and transparent manner. In addition, PIA supports legislation, H.R. 2141, the International Insurance Standards Transparency and Policyholder Protection Act. This legislation would require consultation with Congress, the insurance industry, and consumers with respect to domestic and international insurance standards, negotiations, regulations, or frameworks. International negotiations can have serious consequences for the domestic insurance industry, as well as its consumers, and should be handled in a transparent manner, which should include the opportunity for public comments to be made on proposed agreements.

Capital Standards

The business of insurance is unique and insurance companies must tailor their investments to meet the risk profile of the business they write. Insurance companies must be regulated using insurance standards, not bank-centric standards. While banks and other financial institutions profit by actively seeking out risk, insurance companies profit by insuring <u>against</u> risk. Therefore, it is not prudent to attempt to apply bank-centric standards to insurance entities, as they are completely different.

State insurance regulators have been enforcing capital requirements for some time, and consumers have benefited from this. Unfortunately, actions by the federal government have not acknowledged this and there has been movement to supervise insurance companies using bank-centric standards. To that end, PIA supported the passage in December 2014 of the Insurance Capital Standards Clarification Act (P.L. 113-279). PIA appreciates Congress' bipartisan action to ensure that insurance companies can be regulated based on their unique risk profiles. The Act clarifies that the Federal Reserve Board can apply insurance-based capital standards—rather than bank-centric rules—to the insurance portion of any insurance holding company it oversees. With the passage of P.L. 113-279, the Federal Reserve should focus on proposing proper standards for insurance companies that are now under its supervision.

National Association of Registered Agents and Brokers

In early January, Congress passed legislation creating NARAB. The purpose of NARAB is to provide a mechanism through which non-resident producer licensing requirements may be adopted and applied on a multi-state basis. An insurance agent who chooses to become a member of NARAB would be authorized to sell, solicit, or negotiate insurance in any state for which he or she pays the licensing fee set by the state for any line or lines of insurance specified in the home state license of the agent. PIA supports NARAB and is working to ensure the association is formed in a timely and appropriate manner. PIA thanks Congress for their efforts to pass legislation to create NARAB and their continued efforts to ensure that NARAB is a success.

Conclusion

PIA believes that the proper place for the regulation of insurance is at the state level, which has served the insurance industry and consumers well for over one hundred years. Any attempt to move toward the federal regulation of insurance is inappropriate and would negatively impact policyholders. In addition, as federal entities negotiate on behalf of the United States at the international level it is essential that the industry, including agents, have the opportunity to comment on agreements before they are finalized. It is also imperative that NARAB be formed in a timely and appropriate manner, and the Insurance Capital Standards Clarification Act be implemented as soon as possible. PIA looks forward to continuing our engagement with Congress on these important issues in the months ahead and thanks the committee for holding this hearing today.

//ACLI
Financial Security...for Life.

DIRK KEMPTHORNE
President & Chief Executive Officer

April 20, 2015

Congressman Bill Posey
U.S. House of Representatives
120 Cannon House Office Building
Washington, D.C. 20515

Congressman Brad Sherman
U.S. House of Representatives
2242 Rayburn House Office Building
Washington, D.C. 20515

Bill
Dear Congressman Posey and Congressman Sherman,

I am writing to express the support of the American Council of Life Insurers (ACLI) for the Policyholder Protection Act of 2015, H.R. 1478.

ACLI is a Washington, D.C.-based trade association with approximately 300 member companies operating in the United States and abroad. ACLI members offer life insurance, annuities, retirement plans, long-term care and disability income insurance, and reinsurance, representing more than 90 percent of industry assets and premiums. ACLI member companies invest $5 trillion into the U.S. economy.

H.R. 1478 would afford insurance policyholders in the context of a savings and loan holding company the same protections as those currently provided under the Bank Holding Company Act. ACLI strongly supported language in the Gramm-Leach-Bliley Act constraining the ability of the Federal Reserve to compel movement of funds out of an insurance company that was part of a bank holding company in order to provide a "source of strength" to an affiliated insured depository institution if such action would jeopardize the interests of insurance policyholders. Extending this same protection to an insurer that is affiliated with a savings and loan association reflects sound regulatory policy.

Thank you for your leadership and support of insurance policyholders. We appreciate your consideration of our views.

Sincerely,

Dirk

GOVERNOR DIRK KEMPTHORNE

American Council of Life Insurers
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April 22, 2015

The Honorable Bill Posey
120 Cannon HOB
Washington, DC 20515

The Honorable Brad Sherman
2242 Rayburn HOB
Washington, DC 20515

Dear Congressmen Posey and Sherman:

Thank you for your leadership in introducing the Policy Holder Protection Act (HR 1478). The American Insurance Association supports the Policyholder Protection Act of 2015, and we look forward to working with you to secure the bill's enactment.

The American Insurance Association (AIA) is the leading property-casualty insurance trade organization, representing approximately 325 insurers that write more than $127 billion in premiums each year. AIA member companies offer all types of property - casualty insurance, including personal and commercial auto insurance, commercial property and liability coverage, workers' compensation, homeowners' insurance, medical malpractice coverage, and product liability insurance.

Our members have a strong interest in ensuring that the implementation of the Dodd-Frank Act aligns with the insurance business model and the regulatory system that flows from that model. The Policy Holder Protection Act promotes this goal by clarifying that state insurance regulators' authority to wall off assets to protect policyholder and pay claims will be consistent, and that insurers in distress will be resolved or rehabilitated under appropriate state insurance law. The bill requires that the Federal Deposit Insurance Corporation (FDIC) provide notice to, and input by, state insurance commissioners when an insurance company serves as a source of financial strength or when the FDIC places a lien against an insurance company's assets.

Thank you for your leadership on this important issue. Please do not hesitate to contact us if we can be of any assistance to you or your staff.

Sincerely,

Leigh Ann Pusey

Leigh Ann Pusey
President and CEO

STATE OF CALIFORNIA Dave Jones, *Insurance Commissioner*

DEPARTMENT OF INSURANCE
EXECUTIVE OFFICE
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SACRAMENTO, CA 95814
(916) 492-3500
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April 20, 2015

The Honorable David Vitter
United States Senate
516 Hart Senate Office Building
Washington, D.C. 20510

RE: S. 798 / H.R. 1478 – Policyholder Protection Act – SUPPORT

Dear Senator Vitter:

On behalf of the California Department of Insurance (CDI), I would like to thank you for authoring **S. 798 / H.R. 1478**, the **Policyholder Protection Act.** These bipartisan proposals would reinstate state insurance regulators' critical and proven ability to safeguard insurance policyholders when complex financial firms become unstable.

Under current law, there exists an opportunity that a state regulator would be kept out of the process of an Federal Deposit Insurance Corporation orderly liquidation to ensure the proper steps are taken to protect policyholders. The Policyholder Protection Act would ensure that all tools are available to state insurance regulators to protect policyholders from undue harm and continue to pay claims regardless of the financial condition of an affiliated institution.

As California's Insurance Commissioner, one of my highest priorities is protecting consumers from any adverse actions emanating from insurance company affiliates. CDI performs this duty by routinely reviewing material transactions and conducting resolution proceedings.

The Policyholder Protection Act continues this necessary oversight. Policyholders should not be left holding the bag for a financially stressed or failing bank that is tied to their insurer. Returning discretion to state insurance regulators, rather than federal entities, will enable us to use the most appropriate resolution strategy, including liquidation, rehabilitation and other options to protect the consumer.

Thank you for your important leadership in introducing the Policyholder Protection Act. Please feel free to contact me or Robert Herrell, Deputy Commissioner & Legislative Director, at (916) 492-3565 if you have any questions.

Sincerely,

Dave Jones

DAVE JONES
Insurance Commissioner

cc: The Honorable Jon Tester
The Honorable Bill Posey
The Honorable Brad Sherman
The Honorable Richard Shelby, Chair, Senate Comm. on Banking, Housing & Urban Affairs
The Honorable Jeb Hensarling, Chair, House Comm. on Financial Services

THE COUNCIL

The Council of Insurance Agents & Brokers
701 Pennsylvania Ave NW Suite 750
Washington DC 20004-2608
Main 202 783 4400 Fax 202 783 4410

April 21, 2015

Senator David Vitter
U.S. Senate
516 Hart Senate Office Building
Washington, D.C. 20510

Senator Jon Tester
U.S. Senate
311 Hart Senate Office Building
Washington, D.C. 20510

Congressman Bill Posey
U.S. House of Representatives
120 Cannon House Office Building
Washington, D.C. 20515

Congressman Brad Sherman
U.S. House of Representatives
2242 Rayburn House Office Building
Washington, D.C. 20515

Dear Senator Vitter, Senator Tester, Congressman Posey, and Congressman Sherman:

Thank you for introducing the Policyholder Protection Act of 2015. As you know, your legislation provides needed clarity on the regulation of insurance capital of organizations that are part of larger financial groups regulated by entities without the codified authority to oversee insurance capital. This bill clarifies that even insurers owned by other financial services organizations are subject to the same regulatory system that has successfully protected the capital of insurance companies in the United States for decades. The Dodd-Frank Wall Street Reform Act (Dodd-Frank) intentionally preserved the consumer protection walls and even built on the regulatory scheme in Title V. The Council was a champion of the insurance provisions in Dodd-Frank and endorses the clarifications of several regulatory ambiguities provided by The Policyholder Protection Act.

The Policyholder Protection Act makes three critical clarifications to Dodd-Frank: it clarifies that insurance regulators still have the final word over the regulation of insurance assets; similarly limits the FDIC's ability to place liens on the assets of an insurer or its subsidiary without the approval of the insurance regulator; and provides that insurance regulators retain the right to use "rehabilitation" as a resolution tool and such a decision would not trigger FDIC backup authority. These clarifications decisively seal the regulatory authority over insurer assets with the insurance regulators, and clarifies the relationship of the insurance regulator and the FDIC in a potential resolution of a failed insurer.

The Council thanks you for your leadership on the Policyholder Protection Act and respectively urges Members of Congress to support its passage. We look forward to working with you and your staff to see this to the finish line.

Best,

Ken A Crerar Joel Wood Joel Kopperud

Ken Crerar
President and CEO

Joel Wood
Senior Vice President,
Government Affairs

Joel Kopperud
Vice President,
Government Affairs

National Organization of Life & Health Insurance Guaranty Associations

NCIGF
National Conference of Insurance Guaranty Funds

March 19, 2015

JOINT SUBMISSION OF NOLHGA AND NCIGF REGARDING POLICYHOLDER PROTECTION ACT OF 2015

The National Organization of Life and Health Insurance Guaranty Associations and the National Conference of Insurance Guaranty Funds respectfully submit their joint comments regarding the Policyholder Protection Act of 2015. We believe that the changes contemplated by the Act protect policyholders and make good sense.

NOLHGA and NCIGF were created to support the activities of their member guaranty associations, which were established by state legislatures to protect insurance policyholders whose insurance carriers become insolvent. Their member guaranty associations perform a function in the insurance market that is roughly analogous to the function the Federal Deposit Insurance Corporation performs with respect to its member and insured depository institutions. NOLHGA's members are principally concerned with protecting consumers of failed life, annuity, and health insurers. NCIGF's members are principally concerned with protecting consumers of failed property and casualty insurers. Both organizations coordinate the protections provided by their members when an insurer enters receivership proceedings.

Guaranty associations are part of an overall "seamless web" of policyholder protection that follows insurers from the time they are formed; through the period they operate; and into and through the process of marketplace exit, winding up, and – in cases of insurer failures – receivership. Insurance regulation is all about policyholder protection, and the best way to protect policyholders is to make sure that their claims are paid when due. While the guaranty associations take care of policyholders whose insurers are liquidated in receivership proceedings, state insurance regulators limit the number and severity of insurance company insolvencies by safeguarding the claims-paying ability of insurers. Toward that end, state law empowers insurance regulators to safeguard the claims-paying ability of insurers by preventing the use of insurance company assets by, or for the benefit of, affiliated entities.

The Policyholder Protection Act of 2015 preserves the ability of state regulators to protect an insurer's assets and make sure that policyholder claims are paid when due. It does so in two ways:

- Section 2 of the Act (which limits the Federal Reserve Board's ability to use insurance company assets as a source of strength for savings and loan associations) mirrors the existing limit on the Fed's ability to use insurance company assets as a source of strength for banks. Under the Act, an insurance company's assets could be used as a source of strength for a savings and loan unless the insurer's primary state regulator determined that it would have a material adverse effect on the insurer's financial condition.

- Similarly, Section 3(2) of the Act would restrict the Federal Deposit Insurance Corporation's ability to take a lien on the assets of an insurance company or its subsidiaries, if the insurer's primary state regulator determines that the lien would have a materially adverse impact on policyholders. (The FDIC's orderly liquidation rule includes a similar restriction but lets the FDIC – rather than the state regulator charged with protecting policyholders – determine whether policyholders would be harmed.)

The Act also includes in Section 3(1) a technical fix that recognizes the flexibility that state insurance regulators have under state law to resolve troubled insurers through court-supervised liquidation *or* rehabilitation. Under the fix, a state insurance regulator could pursue rehabilitation of a systemically important insurer without inadvertently triggering the FDIC's back-up authority (under Title II of Dodd-Frank) to initiate liquidation proceedings.

We believe that the changes contemplated by the Act further the goal of policyholder protection and make good sense. We would be pleased to discuss the Act or answer any questions if that would be helpful.

Contact Information

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President
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National Conference of Insurance Guaranty Funds
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Roger H. Schmelzer
President
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Independent Insurance Agents & Brokers of America, Inc.
NAMIC Where the future of insurance has its voice
PCI Property Casualty Insurers Association of America Advocacy. Leadership. Results.

March 18, 2015

Senator David Vitter
U.S. Senate
516 Hart Senate Office Building
Washington, D.C. 20510

Senator Jon Tester
U.S. Senate
311 Hart Senate Office Building
Washington, D.C. 20510

Congressman Bill Posey
U.S. House of Representatives
120 Cannon House Office Building
Washington, D.C. 20515

Congressman Brad Sherman
U.S. House of Representatives
2242 Rayburn House Office Building
Washington, D.C. 20515

Re: The Policyholder Protection Act of 2015

Dear Senator Vitter, Senator Tester, Congressman Posey, and Congressman Sherman:

The undersigned insurance organizations commend Senators David Vitter (R-LA) and Jon Tester (D-MT), and Representatives Bill Posey (R-FL) and Brad Sherman (D-CA) for introducing the Policyholder Protection Act of 2015. State insurance regulation strictly protects the capital of insurance companies that are part of larger financial groups and ensures that those funds are intended and available to pay claims of insurance consumers and do not become jeopardized by risk taking elsewhere within the firm. When Congress passed the Dodd-Frank Wall Street Reform Act (Dodd-Frank), it sought to preserve those important consumer protection walls. The Policyholder Protection Act clarifies and corrects several ambiguities and loopholes to preserve the authority of insurance regulators to protect insurance consumers.

Source of Strength. The bill prevents federal banking regulators from transferring the assets of state regulated insurance companies and their subsidiaries to a bank if the state insurance regulator determines such transfer would harm the financial condition of the insurer – essentially preventing bank regulators from putting state regulated insurers and their consumers at risk to rescue banks. This protection currently exists for bank holding companies but transfers of assets within savings and loan holding companies did not receive similar protection. The Policyholder Protection Act corrects this oversight.

Limit on FDIC Liens. Dodd-Frank permits the FDIC to place a lien on the assets of businesses that are affiliated with a company that is subject to FDIC liquidation. This is another method by which a bank regulator could raid an insurance company's assets that are intended to protect insurance consumers. As with the source of strength provision above, the Policyholder Protection Act would limit the FDIC's ability to place liens on the assets of an insurer or a subsidiary of an insurer without the approval of the state insurance regulator. Otherwise, insurance policyholders might be harmed to benefit non-insurance firms, which was not the intent of Dodd-Frank.

Insurance Resolutions Remain at the State Level. Dodd-Frank appropriately provides that, should the FDIC find that a failing insurer needs to be resolved, the resolution would take place at the state level as is now the case. The FDIC does have "backup" resolution authority in the event that a state regulator fails to initiate liquidations proceedings with respect to the insurer when the FDIC requests it. However, liquidation is not the only potential approach to dealing with a troubled insurer. In some cases, state regulators may choose to put an insurer into *rehabilitation* instead. The bill provides that state insurance regulators retain the right to use rehabilitation as a resolution tool and that a state's decision to initiate rehabilitation rather than liquidation proceedings will not trigger FDIC backup authority. This also corrects an oversight and ensures that troubled insurance companies will continue to be resolved by state insurance regulators and not bank regulators except in the unlikely circumstance where a state insurance regulator fails to take any action on the FDIC's concerns.

We wholeheartedly support this important legislation and encourage its quick passage.

Sincerely,

Independent Insurance Agents & Brokers of America (Big "I")
National Association of Mutual Insurance Companies (NAMIC)
Property Casualty Insurers Association of America (PCI)

NAIC National Association *of* Insurance Commissioners & *The* CENTER *for* INSURANCE POLICY *and* RESEARCH

March 18, 2015

Senator David Vitter
U.S. Senate
516 Hart Senate Office Building
Washington, D.C. 20510

Senator Jon Tester
U.S. Senate
311 Hart Senate Office Building
Washington, D.C. 20510

Congressman Bill Posey
U.S. House of Representatives
120 Cannon House Office Building
Washington, DC 20515

Congressman Brad Sherman
U.S. House of Representatives
2242 Rayburn House Office Building
Washington, DC 20515

Re: The Policyholder Protection Act of 2015

Dear Senator Vitter, Senator Tester, Congressman Posey, and Congressman Sherman:

On behalf of the National Association of Insurance Commissioners (NAIC)[1], we write today to express our strong support for "The Policyholder Protection Act of 2015." This legislation clarifies that state insurance regulatory tools designed to protect policyholders will be available regardless of insurance company structure or financial circumstance. Insurance companies in the United States are subject to a stringent regulatory regime designed with the primary mission of protecting policyholders by ensuring that a company has sufficient funds to pay insurance claims when they come due. One of the most important tools state insurance regulators have to carry out this mission is the ability to protect or "wall off" the insurance legal entity from contagion in the rest of a large and diverse, financial group by preventing its funds or other assets from being used by other affiliated entities. In the unlikely event an insurance company requires resolution, insurance regulators have broad authorities to determine the best course of action in order to ensure that claims will continue to be paid to insurance consumers. Together, these authorities provide critical protections that have long protected insurance consumers, most recently during the financial crisis of 2008 and 2009.

This bipartisan legislation clarifies that these protections will continue to be available to protect consumers irrespective of insurance company organizational structure and irrespective of whether an insurance company is resolved by state insurance regulators pursuant to state law or whether an insurance company affiliate is resolved by the Federal Deposit Insurance Corporation (FDIC) pursuant to federal law. First, the bill provides certainty that state regulators' authority to wall off assets to pay policyholder claims will be consistent across insurer organizational structures. State regulators have long-standing authority under state law to wall off insurance company assets designated for the benefit

[1] Founded in 1871, the NAIC is the U.S. standard-setting and regulatory support organization created and governed by the chief insurance regulators from the 50 states, the District of Columbia and the five U.S. territories. Through the NAIC, state insurance regulators establish standards and best practices, conduct peer review, and coordinate their regulatory oversight. NAIC members, together with the central resources of the NAIC, form the national system of state-based insurance regulation in the U.S.

of policyholders. These authorities also apply to insurers organized as Bank Holding Companies under federal law, but the law governing savings and loan holding companies does not contain the same procedural protections. This bill will extend the policyholder protections in the Bank Holding Company Act and state law to Savings and Loan Holding Companies, thereby creating a level playing field and clarifying that the same set of rules applies across insurer organizational structures.

Second, state insurance regulators have long-standing authorities to liquidate *or rehabilitate* troubled insurance companies. Under Title II of the Dodd-Frank Act, the FDIC has back-up authority to initiate liquidation proceedings in the event a state insurance regulator does not act. In the unlikely event a systemic insurance legal entity requires resolution, this legislation clarifies state regulatory authorities to employ the most appropriate resolution strategy, liquidation *or rehabilitation,* to protect policyholders. It also ensures that the options available to the FDIC with respect to its backup authority under Title II of the Dodd-Frank Act include the options that are available to state regulators.

Lastly, state insurance regulators have long-standing authority to protect policyholder assets from contagion emanating from an affiliate through their ability to review material transactions and to protect policyholders in resolution proceedings. In the event an affiliate of an insurer is systemic and requires resolution, this legislation ensures that assets meant to be available to policyholders will not be subject to liens in such proceedings unless insurance regulators are comfortable that the lien will not have adverse impacts on the company's policyholders and its ability to pay claims.

We commend you for introducing this legislation that protects policyholders by ensuring that the assets or other funds insurance companies have to pay claims for a damaged home or a deceased bread winner are not jeopardized. We urge Congress to support this important effort to enhance policyholder protection.

Sincerely,

Monica Lindeen
NAIC President
Montana Commissioner of
Securities and Insurance

John Huff
NAIC President-Elect
Director of Missouri's Department of Insurance,
Financial Institutions, and Professional Registration

Sharon P. Clark
NAIC Vice President
Kentucky Insurance Commissioner

Theodore K. Nickel
NAIC Secretary-Treasurer
Wisconsin Insurance Commissioner

E. Benjamin Nelson
NAIC Chief Executive Officer

NATIONAL ASSOCIATION OF
PROFESSIONAL
INSURANCE
AGENTS

Local
Agents
Serving
Main Street
America℠

March 31, 2015

Senator David Vitter
United States Senate
Washington, D.C. 20510

Senator Jon Tester
United States Senate
Washington, D.C. 20510

Congressman Bill Posey
U.S. House of Representatives
Washington, D.C. 20515

Congressman Brad Sherman
U.S. House of Representatives
Washington, D.C. 20515

Dear Senator Vitter, Senator Tester, Congressman Posey, and Congressman Sherman:

On behalf of the National Association of Professional Insurance Agents (PIA National), thank you for introducing the Policyholder Protection Act of 2015 (S.798/H.R.1478). PIA National represents independent insurance agents in all 50 states, Puerto Rico, and the District of Columbia. Our members appreciate your leadership in preserving the authority of state insurance regulators to regulate insurance and protect consumers.

Your legislation allows state insurance regulators to protect policyholders in their state by ensuring that insurance companies structured under larger financial firms are not held financially responsible for an affiliated bank's failure or financial crisis. The bill does this by prohibiting federal banking regulators from moving the assets of insurance companies, which are regulated at the state level, to a bank if the state insurance regulator determines it would harm the status of the insurer.

Another area of concern in the Dodd-Frank Wall Street Reform Act (Dodd-Frank) is the possibility of the Federal Deposit Insurance Corporation (FDIC) liquidating a troubled insurer. This current process undercuts state authority, puts policyholders at risk, and negatively impacts insurers. The Policyholder Protection Act would better empower state regulators to rehabilitate a troubled insurer, rather than moving directly to liquidation, if it would benefit consumers. The bill also protects policyholders by limiting the ability of the FDIC to seize insurance company assets intended for policyholder payments when an affiliated financial entity is subject to liquidation.

PIA National greatly appreciates your continued dedication to this issue. We look forward to continuing to work with you on this matter. If PIA National can be of any additional assistance, please contact Jon Gentile, PIA National director of federal affairs, at jonge@pianet.org.

Sincerely,

Mike Becker

Mike Becker
Executive Vice President and CEO
PIA National

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NCOIL

National Conference of Insurance Legislators

...for the states

PRESIDENT: SEN. NEIL BRESLIN, NY
VICE PRESIDENT: SEN. TRAVIS HOLDMAN, IN.
SECRETARY: REP. STEVE RIGGS, KY
TREASURER: SEN. JASON RAPERT, AR

VIA E-MAIL

March 18, 2015

Senator David Vitter U.S. Senate 516 Hart Senate Office Building Washington, D.C. 20510	Senator Jon Tester U.S. Senate 311 Hart Senate Office Building Washington, D.C. 20510
Congressman Bill Posey U.S. House of Representatives 120 Cannon House Office Building Washington, DC 20515	Congressman Brad Sherman U.S. House of Representatives 2242 Rayburn House Office Building Washington, DC 20515

Dear Senator Vitter, Senator Tester, Congressman Posey, and Congressman Sherman:

As Officers of the National Conference of Insurance Legislators (NCOIL), we write on behalf of NCOIL to support the *Policyholder Protection Act of 2015*, legislation that would preserve state insurance regulators' critical and proven ability to safeguard insurance policyholders when complex financial firms become unstable.

NCOIL has long asserted that state officials—who establish the rules that insurers must follow—are the most appropriate arbiters of insurers' financial strength and ability to pay claimants. In line with that belief, the *Policyholder Protection Act* makes clear that state regulators have the final say in whether the assets of an insurer, however it is structured, should be used to strengthen the finances of an affiliate or other related entity.

The legislation wisely recognizes that the protection of policyholders—who buy auto and homeowners' coverage to safeguard their property, and life insurance in the event that a loved one dies—should be paramount in any insurance regulatory decision.

The *Policyholder Protection Act* holds true to the belief that insurers with strong balance sheets should not be required to shore up, at their own hazard, the finances of less prudent corporate relations. Indeed, the legislation upholds the effective "windows and walls" approach of state oversight, in which insurers are isolated from the risky and perhaps less regulated practices of other entities in a financial services group.

In a world where financial services firms are diverse and complex, the *Policyholder Protection Act* is a commonsense way to ensure that funds meant for policyholders are available for policyholders. NCOIL is committed to insurance oversight that is strong and fair, and so we support the legislation.

Please contact Susan Nolan, NCOIL Executive Director, at snolan@ncoil.org or 518-687-0178 with questions.

Sincerely,

Neil D. Breslin   Sen. Travis Holdman   Steven Riggs   [signature]

Sen. Neil D. Breslin, NY NCOIL President	Sen. Travis Holdman, IN NCOIL Vice President	Rep. Steve Riggs, KY NCOIL Secretary	Sen. Jason Rapert, AR NCOIL Treasurer

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Questions for the Record
Housing and Insurance Subcommittee Hearing "The Impact of Domestic Regulatory Standards on the U.S. Insurance Market"
September 29, 2015

Responses of John M. Huff

Congressman Brad Sherman:

Do you view H.R. 1478 the Policyholder Protection Act as important to protect insurance consumers?

A: Yes, Congressman Sherman, HR 1478, the Policyholder Protection Act, is critical to protecting insurance consumers. State insurance regulators are very supportive of your legislation clarifying state insurance regulators' authority to protect consumers within complex financial firms so that policyholder dollars necessary to pay claims for a damaged home or a deceased breadwinner are not jeopardized by complex bets, risk taking, or poor management elsewhere within a firm. Just as large ships have bulkheads to prevent leaks in one area from spreading and sinking the whole ship, state regulators' ability to wall off insurance company assets for their intended purpose can help prevent damage elsewhere from impacting insurance consumers. Consistent with existing federal law governing Bank Holding Companies, the legislation creates a level playing field and ensures insurance regulator authority to wall off insurance company assets would also apply to insurers organized as Savings and Loan Holding Companies. The legislation also clarifies insurance regulators' authority to protect policyholders during resolution of an insurance company, regardless of the company's structure. The bill is widely supported by the insurance industry, insurance consumers, state legislators, and the guaranty fund organizations, and I urge its prompt passage so policyholders can remain well protected moving forward, regardless of how their insurer is organized.

Congressman Keith Rothfus:

In a recent speech at a Conference on Financial Regulation at the Banque De France, Federal Reserve Governor Daniel Tarullo, discussed some detailed thoughts regarding capital requirements for various nonbonding entities. For insurers, Gov. Tarullo stated, "the traditional property-casualty insurance model does not appear to raise significant funding, fire sale, or other macroprudential concerns."

"Similarly, the move of some insurance firms into... capital market activities can work significant changes in the balance sheets of those firms, creating tighter connections to the rest of the financial system."

"Thus the liability side of the balance sheets of firms that are all 'insurance companies' can vary substantially... Yet capital regulation currently applicable to insurance companies seems not to make some of the relevant distinctions."

"In confronting these and similar challenges, I would suggest that a focus on the actual nature of liabilities associated with a firm's activities provides a good starting point for sound analysis."

It appears that Governor Tarullo is essentially noting that different insurance companies are involved in different activities, some of which can be riskier than others. Accordingly, instead of just setting capital charges for all insurers like they are the same, capital requirements should be differentiated based on the risk posed. Nowhere does Gov. Tarullo state that the current definition of an Internationally Active Insurance Group (IAIG) - operating in 3 or more countries and deriving at least 10% of your premium from overseas subsidiaries - is the correct barometer to use to determine which firms should be subject to higher capital charges.

1. *Do you agree with Governor Tarullo's statements that regulators should focus on the actual nature of liabilities associated with an insurer's activities?*

   A: Yes. As the saying goes, and particularly in the case of diversified Internationally Active Insurance Groups, if you've seen one insurance company you've seen one insurance company. Generally, regulators focus on the risks associated with certain activities, including the potential impacts of risk management and mitigation, concentration and diversification, and governance practices. Most insurance groups, particularly those operating in different jurisdictions, have unique corporate structures and business models, which means risked-based group supervision needs to include an understanding of how the various activities and practices might interact to increase or decrease risk. Specifically, the NAIC's Risk-Based Capital (RBC) system is focused on policyholder protection at the legal entity level and requires more capital for riskier products, activities and assets. Principle-Based Reserving (PBR), which we expect to implement in 2017, will replace existing formulaic reserves by major product type with reserve requirements more tailored to the risks of a specific policy. Our RBC formula for life insurers will also be modified to accommodate PBR reserving. In addition, it is important to note that financial analysis is an important supplement to the regulatory capital requirement, and even more tailored risk considerations occur as part of that process for both the current timeframe and prospectively. Additionally, state regulators are now beginning to collect reports from insurers that look across all the entities within a group – including non-insurers and non-US firms – to ascertain the varying risks posed by different activities. Using these tools to focus on liabilities and matching assets to those liabilities, state insurance regulators are able to ensure promises made are promises kept.

2. *If you agree, would you also agree that the International Association of Insurance Supervisors' (IAIS) proposal to subject internationally active insurance groups (IAIGs) to higher capital standards simply based on the number of countries they operate in fails to meet this test?*

   A: The IAIS criteria for IAIGs provide guidance about which companies might be covered by the international group standards but they do not preclude supervisory discretion. Each jurisdiction must consider whether and how it might implement these group standards to enhance effective and efficient cross-border supervision without adding unwarranted new burdens or costs.

3. *Is it not more appropriate to base higher capital standards on the products and activities offered by an (IAIG) instead of simply the number of countries an insurer operates in, which is not indicative of additional risk?*

   A: Yes. Generally, insurers operating in multiple jurisdictions can diversify their risks and thereby reduce their overall concentration of risk. This positive impact should be considered along with any potential increased risk of contagions if some risks or activities are more highly interconnected.

Congressman Andy Barr:

One of the main concerns, I have with the Federal Reserve's work to develop a new capital requirement for insurers under Fed authority, is that I have not heard the Fed clearly articulate the exact concerns it is trying to solve beyond that this was directed by Dodd-Frank and now the Financial Stability Board.

1. *To the panel, what do you believe are the risks, if any, not currently being addressed by state-based insurance capital standards would be corrected by a new Fed standard?*

   A: None. Federal standards would be applied in addition to state standards, but only to certain insurers unless and until they are no longer deemed systemically important or no longer organized as a thrift holding company. In addition to oversight of the insurance group as a whole, the states pay very close attention to the financial strength of individual legal entities. While policyholder protection is the primary goal of insurance regulators, policyholder protection concerns are not divorced from financial stability concerns. In fact, a key component of financial stability is ensuring the protection of consumers such as policyholders. In this regard, the state based insurance company regulatory framework contributes to financial stability by protecting insurers from financial difficulties through tools such as more conservative accounting measures, stringent investment limitations, risk based capital requirements, and asset adequacy testing.

2. *What exactly is inadequate with the current state-based standards? This is of particular concern as these entities have not been designated as systemically important financial institutions (SIFIs), but simply happen to be insurers who also own a banking entity. Is there a systemic risk posed by the insurance industry? How would a federal or international capital standard actually moderate that risk?*

   A: We don't think insurance in the traditional sense poses any extraordinary risks to the system. To the contrary, we believe the insurance and reinsurance sectors together typically help reduce financial risks. When Congress dissolved the Office of Thrift Supervision (OTS), its authority over thrift holding companies, including those with insurance companies, was transferred to the Federal Reserve. Some of these firms are primarily engaged in insurance operations and have a small banking entity. In such cases, it is not clear that additional regulatory requirements beyond those provided by the state system and those typically required for the specific banking entity are even necessary.

3. *As to non-bank SIFIs, for which the Fed also has authority to set new capital standards, what are your thoughts on simply having the Fed require them to hold a little more capital through an additional surcharge instead of coming up with an entire new regulatory regime for those companies?*

   A: We have had a state risk-based capital system for insurers in place for many years and have briefed the Fed in detail to encourage consistency and compatibility. Our view is that any designations should be temporary and steps should be taken by regulators and companies to address any specific concerns to enable those companies to be removed from the list. That means in the first instance FSOC needs to do a better job of providing guidance to firms and regulators of what specific concerns need to be addressed. Firms and regulators should then focus their efforts on those specific areas of concern. The other regulatory requirements for non-bank SIFI's should primarily be a stop-gap until these concerns are directly addressed. However, it is important to remember that these additional requirements imposed on non-bank SIFI's are by virtue of FSOC's determination that a firm's failure could have a destabilizing impact on the broader economy. While we have disagreed with certain of FSOC's non-bank designations to date, the regulation around those non-bank SIFI's should appropriately take into account any risks they potentially pose until such times the activities of concern are specifically identified and directly addressed.

Finally, the Fed and FIO are overseas working on an International Capital Standard (ICS) to apply to some U.S. companies that the Fed and FIO have no legal authority to regulate. I am very concerned that the development of an ICS is being done mostly apply European Solvency II-style regulation onto U.S. companies, with the outcome being that our vibrant and diverse domestic industry becoming less competitive. When Congress passed Dodd-Frank, it was decided with a bipartisan consensus that insurance should continue to be regulated at the state level.

4. *Never did Congress say, insurance should be regulated through multilateral international forums with no oversight by Congress. Do you agree with this statement? Does Dodd-Frank explicitly direct the Fed to engage in international capital standard rulemaking?*

   A: Insurance is not regulated at the international level, but there is a standard setting process, and that process is less transparent or accountable to policyholders and local governments than our domestic processes. The IAIS is seeking to set international standards that can be applied by all jurisdictions, but every jurisdiction, including ours, determines for itself the best way to meet those standards, based on similar principles, practices or outcomes. The FIO and the FRB each have their own limited authorities over insurance under Dodd-Frank and are subject to Congressional oversight of their views and positions advocated on international standards. State regulators working together are responsible for the safety and soundness of all insurers operating in the U.S. We work in cooperation with other regulators around the world through international supervisory colleges or meetings to review the group-wide activities and risk management of global insurance groups and to address any cross-border regulatory concerns. If we believe any standards set internationally are not appropriate for the United States, we will not implement them.

Congressman Dennis Ross:

Currently, the IAIS and its U.S. participants are moving forward with the development of a new High-Loss Absorbency (HLA) capital surcharge for the Global Systemically Important Insurers (G-SIIs). This new proposal was tentatively approved and released on Monday, October 5th. While I am still reviewing this proposal, I am very concerned that this provision was not developed and adopted in the U.S. first before being adopted through the IAIS and FSB.

1. *Why are we moving forward and rushing to finish this new HLA requirement when our domestic regulators have not created a U.S. SIFI surcharge first? If we are to follow the "U.S. first" approach, shouldn't we first design our U.S. SIFI surcharge before developing a global one at the IAIS? And, furthermore, why are we rushing to develop an HLA to add on top of the Basic Capital Requirement (BCR) when eventually the International Capital Standard (ICS) will replace the BCR and then the regulators will have to entirely redo the HLA anyway?*

   A: There are many issues of concern with the IAIS HLA process, including the threshold questions of whether or not certain U.S. insurers pose threats to the financial system and the notion that higher capital requirements are warranted and would be effective. In any case, we expect there will be significant revisions to the HLA and other capital standard proposals as they move through many more stages of the IAIS development process. U.S. state insurance regulators believe that IAIS standards should be flexible enough to recognize and be compatible with our highly effective state-based system in the U.S. If, in the judgement of U.S. insurance regulators, an international standard is not appropriate for the United States and the implementation of such standard is within our purview, we will not implement it.

2. *Are we abandoning our "U.S. first" approach to meet artificial, unrealistic and unwise political timetables?*

   A: We have long argued at the IAIS that development of international standards should not work backwards from unrealistic and artificial deadlines if they are to be credible and implementable. The states are continuing to enhance our NAIC Risk-Based Capital system and its strong track record, which has demonstrated its effectiveness in particular over the past decade on a nationwide basis. The NAIC is beginning work on a group capital calculation for use as a tool by state insurance regulators when performing insurance group analysis. This calculation will utilize an RBC aggregation approach rather than establishing a new methodology that does not consider the time-tested RBC calculation. While international standard setting activity should inform our work, we are not constrained by it.

3. *Did "Team USA" agree to the newly proposed HLA before IAIS and FSB approved it?*

   A: Treasury, the Federal Reserve and the NAIC staff discussed their respective perspectives and concerns on HLA. There is general agreement that HLA will need to be further modified as other related IAIS workstreams are further refined. In particular, the G-SII methodology and Non Traditional Non Insurance workstream (which seeks to further clarify which products and activities give rise to potential systemic risks) are important for assessing the overall HLA framework. These workstreams are still in progress, with public consultations expected later this year. With these important caveats, Team USA were supportive of the HLA proposal as a starting point for further testing and future revisions as these related projects move towards their completion.

4. *How will this requirement be formally adopted in the U.S.?*

A: In passing Dodd Frank, Congress gave the Fed its contingent authority to impose enhanced standards, including higher capital requirements such as an HLA, on any U.S. insurer that is designated by the FSOC as presenting an extraordinary risk to the financial system by the FSOC. Designations should be temporary and extraordinary, and therefore so should be the enhanced measures to address the potential risk.

Chairman Blaine Luetkemeyer:

During the Subcommittee hearing, several Members of Congress on both sides of the aisle expressed concern that international capital standards are being put in place before the development of a domestic capital regime by the Federal Reserve Board. Based on your response at the hearing, I remain concerned that the international capital framework is outpacing the domestic rule making. Specifically, earlier this week, the International Association of Insurance Supervisors released an initial version of the Higher Loss Absorbency rule (HLA), which will apply to three US firms. You acknowledged problems with the HLA and noted that sequencing is "a concern."

1. *Will you commit to using your influence in international negotiations to prevent work on international standards from preempting the appropriate development of the domestic framework?*

   A: We have consistently raised concerns with the IAIS timetables, and we believe that IAIS standards should be flexible enough to recognize and be compatible with our highly effective state-based system in the U.S.

FSOC Member Roy Woodall has indicated that his office should have greater access to the proceedings of international standard setting organizations such as the International Association of Insurance Supervisors and the Financial Stability Board.

2. *What is your reaction to his comments that he has been "deliberately prevented from playing any non-public role at the international level" and how can your agency improve coordination and cooperation with Mr. Woodall?*

   A: We have excellent relations and communicate frequently with Mr. Woodall. The NAIC supports including him in international discussions about the role of the insurance sector in financial stability.

U.S. House of Representatives
Committee on Financial Services
Subcommittee on Housing and Insurance
Questions for the Record for Michael McRaith
Director, Federal Insurance Office, U.S. Department of the Treasury
"The Impact of Domestic Regulatory Standards on the U.S. Insurance Market"
September 29, 2015

From Chairman Luetkemeyer

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Answer: Treasury's Federal Insurance Office (FIO) is committed to providing global leadership on behalf of the United States on prudential aspects of international insurance matters at the International Association of Insurance Supervisors (IAIS). Working at the IAIS with state insurance regulators, NAIC staff, and the Federal Reserve, FIO supported the 2015 release of the first version of higher loss absorbency (HLA). FIO's support was conditioned upon language in the Preface of that document that stated explicitly that the concepts of that document are preliminary and will be modified going forward. In particular, the Preface provides:

> *This document describes the first version of the Higher Loss Absorbency (HLA) requirement for Global Systemically Important Insurers (G-SIIs). The HLA builds on the Basic Capital Requirements (BCR) and addresses additional capital requirements for G-SIIs reflecting their systemic importance in the international financial system. The current foundation for the HLA is the BCR, which the IAIS intends to replace with the Insurance Capital Standard (ICS) as that foundation when the ICS is developed. As the ICS is developed, the design and calibration of the HLA will be reviewed. Additionally, certain aspects of the HLA relate to requirements applicable to other regulated financial sectors (e.g. banking, asset management) for which capital rules already exist or are under development. The IAIS will continue to ensure consistency with such requirements so as to minimize opportunities for regulatory arbitrage.*
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> *The IAIS acknowledges the need to monitor developments and to make changes to the HLA as necessary. In the near term, the ongoing and related IAIS work on the definitions of Non-Traditional and Non-Insurance (NTNI) activities and on the framework of the G-SII Assessment Methodology – each to be the subject of separate consultations to be released by the IAIS in November 2015 – will be closely monitored and evaluated in the context of the HLA. Changes to the NTNI definitions or the G-SII Assessment Methodology will lead to a change in HLA design and calibration.*

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> *As described in Section 7.2 of this HLA Document, it is anticipated the periodic annual analyses of insurer field testing data in 2016-2018 and the BCR and HLA review process will also lead to changes to the HLA design and calibration, prior to the proposed implementation of HLA.*

For international insurance standards developed through the IAIS, implementation occurs through national authorities. In the United States, implementation will occur through the state insurance regulatory and legislative processes and, for those firms subject to oversight by the Board of Governors for the Federal Reserve System, through the Federal Reserve's conventional rulemaking processes.

Question: FSOC Member Roy Woodall has indicated that his office should have greater access to the proceedings of international standard setting organizations such as the International Association of Insurance Supervisors and the Financial Stability Board. What is your reaction to his comments that he has been "deliberately prevented from playing any non-public role at the international level" and how can your agency improve coordination and cooperation with Mr. Woodall?

Answer: As provided in the Dodd-Frank Act, the Financial Stability Oversight Council (Council) is represented internationally by the Secretary of the Treasury, who serves as Chairman of the Council. Also, as provided in the Dodd-Frank Act, FIO coordinates and develops federal policy on prudential aspects of international insurance matters, including representing the United States at the IAIS. In this role, we work closely with the Federal Reserve, the 56 members of the National Association of Insurance Commissioners (NAIC), each of whom is a member of the IAIS, and staff of the NAIC. As a result, the United States benefits at the IAIS from the active engagement of all public agencies involved with insurance sector oversight.

I brief and update the Council's independent member with insurance expertise about developments at the IAIS. FIO has met with the Council's independent member whenever such a meeting has been requested and has initiated meetings with the Council's Independent Member. FIO has invited the Council's Independent Member to sessions with U.S. insurance sector stakeholders held at Treasury that discuss IAIS developments, and will continue to do so.

Question: During the Subcommittee hearing, John Huff indicated that the state insurance commissioners were not consulted by the Department of Labor (Department) on the Department's fiduciary duty rule before proposal. Did the Department consult the Federal Reserve or the Treasury Department, and specifically the Federal Insurance Office, prior to publication of the proposal? Please detail all interactions between your respective agencies and the Department.

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Answer: FIO works closely with the Treasury team dedicated to developing, promoting and implementing private sector retirement security initiatives. Both prior to and since the publication of the proposal, Treasury has provided extensive feedback on the Department of Labor's fiduciary rule. FIO has also, at the request of the Department of Labor, provided technical assistance with respect to insurance industry and regulatory matters.

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From Representative Sherman

Question: Do you support H.R. 1478, the Policyholder Protection Act? How should regulators treat the assets of regulated insurers when an affiliated bank is in crisis?

Answer: As Congress considers making statutory changes along the lines of H.R. 1478, it is important to consider several issues.

The orderly liquidation of a financial holding company is an important tool for financial regulators to ensure the protection of consumers and the stability of the financial marketplace. Many financial holding companies have insurance entities within the group, either as the parent company or as a subsidiary. For that reason, both federal and state statutes include protections specific to how regulated insurance entities are treated during the orderly liquidation process. For example, current state statutes prohibit the transfer of more than a *de minimis* amount of capital from a state-regulated licensed insurance entity. Under Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the orderly liquidation authority defers to state laws related to the receivership process for insurance entities, including those prohibiting transfer of capital.

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Answer: Treasury's Federal Insurance Office (FIO) is committed to providing global leadership on behalf of the United States on prudential aspects of international insurance matters at the International Association of Insurance Supervisors (IAIS). Working at the IAIS with state insurance regulators, NAIC staff, and the Federal Reserve, FIO supported release of the first version of higher loss absorbency (HLA). FIO's support was conditioned upon language in the Preface of that document that stated explicitly that the concepts of that document are preliminary and will be modified going forward. In particular, the Preface provides:

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review process will also lead to changes to the HLA design and calibration, prior to the proposed implementation of HLA.

For international insurance standards developed through the IAIS, implementation occurs through national authorities. In the United States, implementation will occur through the state insurance regulatory and legislative processes and, for those firms subject to oversight by the Board of Governors for the Federal Reserve System, through the Federal Reserve's conventional rulemaking processes.

Question: Why are we moving forward and rushing to finish this new HLA requirement when our domestic regulators have not created a U.S. SIFI surcharge first? If we are to follow the "U.S. first" approach, shouldn't we first design our U.S. SIFI surcharge before developing a global one at the IAIS? And, furthermore, why are we rushing to develop an HLA to add on top of the Basic Capital Requirement (BCR) when eventually the International Capital Standard (ICS) will replace the BCR and then the regulators will have to entirely redo the HLA anyway?

Answer: As noted above, the HLA is an international standard to be implemented in a tailored manner by national authorities and to be applied to global systemically important insurers (G-SIIs). Further, the 2015 version of HLA is preliminary and subject to substantial change and improvement in the coming years, including as the IAIS develops an insurance capital standard (ICS).

Question: Are we abandoning our "U.S. first" approach to meet artificial, unrealistic and unwise political timetables?

Answer: The work of the U.S. participants (state regulators, NAIC staff, Federal Reserve and FIO) at the IAIS allows for the United States to have a leading role in the development of international insurance standards. As has occurred for approximately 20 years, the IAIS establishes insurance sector standards that are then incorporated by national authorities. In this sense, the IAIS allows for the development of best practice standards that are tailored to a country's regulatory and market needs.

Question: Did "Team USA" agree to the newly proposed HLA before IAIS and FSB approved it? How will this requirement be formally adopted in the U.S.? Will the Federal Reserve do a formal rule making to adopt it on the U.S. Insurance SIFIs? If so, what would be the timing of that rule making? How will a potential factor in the IAIS's stated desire of continuing to change and amend the HLA over the next 4 years?

Answer: Working at the IAIS with state insurance regulators, NAIC staff, and the Federal Reserve, FIO supported release of the first version of higher loss absorbency (HLA). FIO's support was conditioned upon language in the Preface of that document that stated explicitly that the concepts of that document are preliminary and will be modified going forward. In particular, the Preface provides:

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As to non-bank SIFIs, for which the Fed also has authority to set new capital standards, what are your thoughts on simply having the Fed require them to hold a little more capital through an additional surcharge instead of coming up with an entire new regulatory regime for those companies?

Finally, the Fed and FIO are overseas working on an International Capital Standard (ICS) to apply to some U.S. companies that the Fed and FIO have no legal authority to regulate. I am very concerned that the development of an ICS is being done mostly apply European Solvency II-style regulation onto U.S. companies, with the outcome being that our vibrant and diverse domestic industry becoming less competitive. When Congress passed Dodd-Frank, it was decided with a bipartisan consensus that insurance should continue to be regulated at the state level. Never did Congress say, insurance should be regulated through multilateral international forums with no oversight by Congress. Do you agree with this statement? Does Dodd-Frank explicitly direct the Fed to engage in international capital standard rulemaking?

Answer: As stated by the Federal Reserve, its capital standard will supplement existing legal-entity supervision with a perspective that considers the risks across the entire firm, including risks that emanate from non-insurance subsidiaries and other entities within the group. Additionally, the Federal Reserve has stated that it is focused on constructing a domestic regulatory capital framework for supervised insurance holding companies that is well-tailored to the business of insurance.

While many agree that conventional insurance activities do not present a threat to U.S. financial stability, the recent financial crisis illustrated both that insurers are important participants in the financial sector and that insurers can engage in other financial activities that may threaten U.S. financial stability. A group capital standard, as opposed to a capital standard for an single entity, will allow for supervision based on the totality of products and activities of the holding company, not only the insurance activities.

With respect to the supervision of insurance firms designated by the Council, Sections 165 and 171, as amended, allow the Federal Reserve to tailor the enhanced supervisory measures to the firm under its supervision.

The Financial Stability Board supports the development of supervisory standards in order to promote global financial stability and an internationally level playing field. FIO has the statutory authority to coordinate and develop Federal policy on prudential aspects of international insurance matters, including representing the United States at the IAIS. In this role, we collaborate closely with the state insurance regulators (all 56 NAIC members are also members of the IAIS), NAIC staff, and the Federal Reserve. Importantly, the IAIS is not a regulator but, rather, a standard-setting organization that does not promulgate law or regulation.

As a founding member of the IAIS in 1994, U.S. state insurance regulators have supported and implemented international insurance standards for many years. IAIS capital standards will be implemented in the United States by the Federal Reserve and by state regulatory and legislative processes.

U.S. House of Representatives
Committee on Financial Services
Subcommittee on Housing and Insurance
Questions for the Record for Michael McRaith
Director, Federal Insurance Office, U.S. Department of the Treasury
"The Impact of Domestic Regulatory Standards on the U.S. Insurance Market"
September 29, 2015

From Representative Rothfus

In a recent speech at a Conference on Financial Regulation at the Banque De France, Federal Reserve Governor Daniel Tarullo, discussed some detailed thoughts regarding capital requirements for various nonbonding entities. For insurers, Gov. Tarullo stated, "the traditional property-casualty insurance model does not appear to raise significant funding, fire sale, or other macroprudential concerns."

"Similarly, the move of some insurance firms into... capital market activities can work significant changes in the balance sheets of those firms, creating tighter connections to the rest of the financial system."

"Thus the liability side of the balance sheets of firms that are all 'insurance companies' can vary substantially... Yet capital regulation currently applicable to insurance companies seems not to make some of the relevant distinctions."

"In confronting these and similar challenges, I would suggest that a focus on the actual nature of liabilities associated with a firm's activities provides a good starting point for sound analysis."

It appears that Governor Tarullo is essentially noting that different insurance companies are involved in different activities, some of which can be riskier than others. Accordingly, instead of just setting capital charges for all insurers like they are the same, capital requirements should be differentiated based on the risk posed. Nowhere does Gov. Tarullo state that the current definition of an Internationally Active Insurance Group (IAIG) - operating in 3 or more countries and deriving at least 10% of your premium from overseas subsidiaries - is the correct barometer to use to determine which firms should be subject to higher capital charges.

Question: Do you agree with Governor Tarullo's statements that regulators should focus on the actual nature of liabilities associated with an insurer's activities? If you agree, would you also agree that the International Association of Insurance Supervisors' (IAIS) proposal to subject internationally active insurance groups (IAIGs) to higher capital standards simply based on the number of countries they operate in fails to meet this test? Is it not more appropriate to base higher capital standards on the products and activities offered by an (IAIG) instead of simply the number of countries an insurer operates in, which is not indicative of additional risk?

Answer: The focus of regulators will vary depending upon the statutory authority on which the regulator exists and operates. Whether insurance regulators should focus on the actual nature of liabilities associated with an insurer's activities will depend upon the nature of the activities. For example, in the recent financial crisis, U.S. financial stability was threatened by an insurance firm engaged in non-insurance activities. Importantly, the IAIS global insurance capital standard will not be premised upon the number of countries in which an insurer operates but, rather, the nature of the insurer's activities and products sold in markets around the world.

Questions for Thomas Sullivan, Senior Adviser, Board of Governors of the Federal Reserve System from Chairman Luetkemeyer:

1. During the Subcommittee hearing, several Members of Congress on both sides of the aisle expressed concern that international capital standards are being put in place before the development of a domestic capital regime by the Federal Reserve Board. Based on your response at the hearing, I remain concerned that the international capital framework is outpacing the domestic rule making. Specifically, earlier this week, the International Association of Insurance Supervisors released an initial version of the Higher Loss Absorbency rule (HLA), which will apply to three US firms. You acknowledged problems with the HLA and noted that sequencing is "a concern." Will you commit to using your influence in international negotiations to prevent work on international standards from preempting the appropriate development of the domestic framework?

We are working to develop a proposal on capital requirements for the insurance holding companies we supervise. As I stated in my testimony, we are exercising great care as we approach our mandate and we are committed to developing our domestic insurance capital framework through a transparent rulemaking process that allows for a public comment period on a concrete proposal. We will continue to engage with interested parties as we move forward.

We are also working to ensure that any international standard adopted allows for the equitable treatment of U.S.-based insurers operating abroad. The international insurance standards currently under development at the International Association of Insurance Supervisors (IAIS) are not self-executing or binding on the U.S., either for states or the federal government. The Federal Reserve will evaluate any standard for its appropriateness for the U.S. market, U.S. insurers, and consumers. International regulatory standards cannot be imposed on U.S. firms by an international body; rather, these standards apply in the United States only if adopted by the appropriate U.S. regulators in accordance with applicable rulemaking procedures conducted here. Additionally, none of the standards are intended to replace the existing legal entity requirements that are already in place.

We appreciate the importance of your comments regarding the Higher Loss Absorbency (HLA) requirement as it is presently set out by the IAIS. The HLA requirement remains under development, as noted in the HLA Document. We remain committed to developing and advocating a Team USA position, in collaboration with the Federal Insurance Office (FIO), state insurance commissioners, and National Association of Insurance Commissioners (NAIC), in the development of international insurance standards that best meet the needs of the U.S. insurance market.

2. FSOC Member Roy Woodall has indicated that his office should have greater access to the proceedings of international standard setting organizations such as the International Association of Insurance Supervisors and the Financial Stability Board. What is your reaction to his comments that he has been "deliberately

prevented from playing any non-public role at the international level" and how can your agency improve coordination and cooperation with Mr. Woodall?

The Federal Reserve's supervisory activities for insurers include collaborating with our regulatory counterparts internationally. As part of this role, late in 2013, the Federal Reserve joined our state insurance supervisory colleagues from the NAIC, and the FIO, as members of the IAIS. Accordingly, the Federal Reserve has been and will continue to be engaged in the development of global standards for regulating and supervising international insurers in an engaged partnership with our colleagues. The Federal Reserve is committed to working with all bodies that have a role in the oversight of the insurance industry, including the NAIC, state insurance regulators, the independent insurance member of the Financial Stability Oversight Council, and the FIO, and respects the different roles and authorities provided to each under state and federal law. Our multiparty dialogue, while respectful of each of our individual authorities, strives to develop consensus positions on global insurance policy. Mr. Woodall references disagreement among U.S. IAIS members about his participation in international insurance standards development, however, the Federal Reserve has not opposed Mr. Woodall's participation nor acted to prevent his participation.

3. During the Subcommittee hearing, John Huff indicated that the state insurance commissioners were not consulted by the Department of Labor (Department) on the Department's fiduciary duty rule before proposal. Did the Department consult the Federal Reserve or the Treasury Department, and specifically the Federal Insurance Office, prior to publication of the proposal? Please detail all interactions between your respective agencies and the Department.

The Department of Labor did not consult with the Federal Reserve Board prior to the Department's publication of its proposed rule on "Definition of the Term 'Fiduciary'" and related topics (80 F.R. 21928).

<u>Questions for Thomas Sullivan, Senior Adviser, Board of Governors of the Federal Reserve System from Representative Barr:</u>

1. One of the main concerns, I have with the Federal Reserve's work to develop a new capital requirement for insurers under Fed authority, is that I have not heard the Fed clearly articulate the exact concerns it is trying to solve beyond that this was directed by Dodd-Frank and now the Financial Stability Board.

To the panel, what do you believe are the risks, if any, not currently being addressed by state-based insurance capital standards would be corrected by a new Fed standard? What exactly is inadequate with the current state-based standards? This is of particular concern as these entities have not been designated as systemically important financial institutions (SIFIs), but simply happen to be insurers who also own a banking entity. Is there a systemic risk posed by the insurance industry? How would a federal or international capital standard actually moderate that risk?

With the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Dodd-Frank Act), the Federal Reserve assumed responsibility as the consolidated supervisor of insurance holding companies that own thrifts, as well as insurance companies designated by the Financial Stability Oversight Council (FSOC). Our principal supervisory objectives for all the insurance holding companies that we oversee are protecting the safety and soundness of the consolidated firms and their subsidiary depository institutions. For FSOC designated firms, our supervisory objectives also include mitigating their risks to U.S. financial stability. The Federal Reserve's consolidated supervision supplements existing state based legal-entity supervision with a perspective that considers the risks across the entire firm. The Federal Reserve's role in monitoring and mitigating risks to financial stability seeks to ensure, as appropriate, that supervised insurers remain solvent as going concerns, maintain their positions as financial intermediaries even in times of stress, and are resolvable in a manner that is not destabilizing to the financial system when resolution is required.

The FSOC designated three insurers that, based on the standards set forth in the Dodd-Frank Act, could pose a threat to the financial stability of the U.S. Our supervisory efforts to date have focused on strengthening firms' risk identification, measurement, and management; internal controls; and corporate governance. In addition, the Dodd-Frank Act authorizes the Federal Reserve to establish consolidated requirements at the holding company level, in contrast to the capital requirements that are imposed under individual state insurance laws on insurance companies on a stand-alone, legal entity basis.

We conduct our consolidated supervision of all insurance firms in coordination with state insurance regulators who continue their established oversight of the insurance legal entities. The supervisory program continues to be tailored to consider the unique characteristics of insurance operations and to rely on the work of the primary functional regulator(s) to the greatest extent possible. We recognize and appreciate the importance of state insurance regulators' mission to protect policyholders and we continue to coordinate with state insurance regulators in their protection of policyholders and aim to avoid replicating the supervision that they already perform. We do not believe the mission of protecting policy holders, which is the primary focus of state insurance regulators, and ensuring the safety and soundness of the consolidated firm and mitigating an FSOC designated firm's risk to financial stability which are the primary areas of focus of the Federal Reserve's supervisory program are mutually exclusive propositions.

We have been engaging extensively with the National Association of Insurance Commissioners (NAIC), Federal Insurance Office (FIO), independent experts, regulated entities, and market participants to solicit feedback on capital frameworks that would be consistent with federal requirements.

We conduct our consolidated supervision efforts in a manner that is complementary to, and coordinated with, other insurance regulators. We leverage the work of state insurance regulators where possible and continue to look for opportunities to further coordinate with them.

2. As to non-bank SIFIs, for which the Fed also has authority to set new capital standards, what are your thoughts on simply having the Fed require them to hold a little more capital through an additional surcharge instead of coming up with an entire new regulatory regime for those companies?

Last year, Congress enacted the Insurance Capital Standards Clarification Act of 2014 (S. 2270), which amended the provision of the Dodd-Frank Act that required the minimum capital standards for banks be applied to any insurance holding company that controls an insured depository institution or is designated for Federal Reserve supervision by the FSOC. Using the greater adaptability provided by this amendment to the Dodd-Frank Act, the Federal Reserve is currently considering various options for how to establish a capital regime for insurance firms we supervise.

The Federal Reserve continues to exercise great care as it approaches its statutory mandate. The Federal Reserve is focused on constructing a domestic regulatory capital framework for our supervised insurance holding companies that is well tailored to the business of insurance and we are engaging stakeholders at various levels. We are committed to following a transparent rulemaking processes to develop our insurance capital framework, which will allow for public comment period on a concrete proposal and will continue to engage with interested parties as we move forward.

3. Finally, the Fed and FIO are overseas working on an International Capital Standard (ICS) to apply to some U.S. companies that the Fed and FIO have no legal authority to regulate. I am very concerned that the development of an ICS is being done mostly apply European Solvency II-style regulation onto U.S. companies, with the outcome being that our vibrant and diverse domestic industry becoming less competitive. When Congress passed Dodd-Frank, it was decided with a bipartisan consensus that insurance should continue to be regulated at the state level. Never did Congress say, insurance should be regulated through multilateral international forums with no oversight by Congress. Do you agree with this statement? Does

Dodd-Frank explicitly direct the Fed to engage in international capital standard rulemaking?

The Federal Reserve participates in the International Association of Insurance Supervisors (IAIS) along with fellow U.S. members, the FIO and the NAIC. We participate as the supervisor of nonbank systemically important financial institutions and savings and loan holding companies with significant insurance activities. We advocate for the development of international standards at the IAIS that meet the needs of the domestic insurance market and consumers. Standards developed at the IAIS are not self-executing, or binding on the U.S. unless adopted by the appropriate U.S. lawmakers or regulators in accordance with applicable domestic laws and rulemaking procedures. These deliberations in part follow the direction of Section 175 of the Dodd-Frank Act that the Board of Governors work through appropriate international organizations to encourage comprehensive prudential supervision and regulation of interconnected financial companies.

Questions for Thomas Sullivan, Senior Adviser, Board of Governors of the Federal Reserve System from Representative Ross:

1. Currently, the IAIS and its U.S. participants are moving forward with the development of a new High-Loss Absorbency (HLA) capital surcharge for the Global Systemically Important Insurers (G-SIIs). This new proposal was tentatively approved and released on Monday, October 5th. While I am still reviewing this proposal, I am very concerned that this provision was not developed and adopted in the U.S. first before being adopted through the IAIS and FSB.

Why are we moving forward and rushing to finish this new HLA requirement when our domestic regulators have not created a U.S. SIFI surcharge first? If we are to follow the "U.S. first" approach, shouldn't we first design our U.S. SIFI surcharge before developing a global one at the IAIS? And, furthermore, why are we rushing to develop an HLA to add on top of the Basic Capital Requirement (BCR) when eventually the International Capital Standard (ICS) will replace the BCR and then the regulators will have to entirely redo the HLA anyway?

The Federal Reserve continues to focus on constructing a domestic regulatory capital framework for our supervised insurance holding companies that is well tailored to the business of insurance. We are engaging with insurance companies, trade groups, actuaries, accountants, academics and other interested parties as we move forward. We are committed to following a transparent rulemaking processes that will include a public comment period on a concrete proposal.

The timeline for the development of our rulemaking is distinct from the activities of the International Association of Insurance Supervisors (IAIS). Waiting to participate in IAIS deliberations on the international capital standards until after our domestic insurance capital standards have been finalized could decrease the influence that the United States has over the international standards and could result in international standards that are less tailored to the U.S. insurance market, and places U.S. insurers at a competitive disadvantage to their foreign competitors.

We appreciate the importance of your comments regarding the IAIS Higher Loss Absorbency (HLA) requirement. The HLA requirement remains under development, as the HLA Document expressly notes. We remain committed to developing and advocating a "Team USA" position, in collaboration with the Federal Insurance Office (FIO), state insurance commissioners, and National Association of Insurance Commissioners (NAIC), in the ongoing process of developing international insurance standards that best meet the needs of the U.S. insurance market. We are working to ensure that the HLA, or any standard adopted, allows for the equitable treatment of U.S.-based insurers operating abroad, including the avoidance of undue regulatory burden.

It is important to note that the IAIS does not have any regulatory authority and that standards developed at the IAIS are not self-executing or binding on the U.S. unless adopted by the appropriate U.S. lawmakers or regulators in accordance with applicable domestic laws and rulemaking procedures. The Federal Reserve will evaluate any standard for its appropriateness for the U.S. market, U.S. insurers, and consumers. International regulatory standards cannot be imposed on U.S. firms by an international body; rather, these standards apply in the U.S. only if adopted by the appropriate U.S. regulators in accordance with applicable rulemaking procedures conducted here.

2. Are we abandoning our "U.S. first" approach to meet artificial, unrealistic and unwise political timetables?

As I have stated previously, we will not be driven by artificial timelines to develop our domestic standards. We are approaching our mandate carefully. In our development of domestic standards, we continue to solicit views from external parties and engage in internal deliberation as we prepare to present the Federal Reserve with options for domestic capital frameworks. We are committed to developing our domestic insurance capital framework through a transparent rulemaking process that allows for a public comment period on a concrete proposal. Any standard set at the international level is not binding on the Federal Reserve, and would only be adopted in accordance with applicable rulemaking procedures. We continue to develop appropriate domestic capital standards while maintaining our voice in the international standards development process.

3. Did "Team USA" agree to the newly proposed HLA before IAIS and FSB approved it? How will this requirement be formally adopted in the U.S.? Will the Federal Reserve do a formal rule making to adopt it on the U.S. Insurance SIFIs? If so, what would be the timing of that rule making? How will a potential factor in the IAIS's stated desire of continuing to change and amend the HLA over the next 4 years?

It is correct to note that we anticipate the HLA evolving over time; in particular, work currently underway at the IAIS to further develop how non-traditional and non-insurance are defined will lead to changes in the HLA requirement developed at the IAIS. It is important to keep in mind that the international insurance standards currently under development at the IAIS are not self-executing or binding on the U.S., neither at the state nor federal levels. Rather, these standards apply in the U.S. only if adopted by the appropriate U.S. regulators in accordance with applicable rulemaking procedures conducted here. Additionally, none of the standards are intended to replace the existing legal entity requirements that are already in place. The Federal Reserve continues to develop its domestic capital framework for supervised insurers, including possible requirements to address a supervised insurer's systemic importance that is well tailored to the business of insurance.

4. In adopting the Collins Fix, the legislative history makes clear that as generally applied to insurance companies, Fed deferral to state regulatory capital requirements is a viable option. Is it your view that existing state RBC requirements are inadequate as applied insurance companies, and if that is your view, how do you explain why insurance companies overwhelmingly outperformed banks in meeting their obligations during the last financial crisis?

S. 2270, The Insurance Capital Standards Clarification Act of 2014, gave the Federal Reserve the flexibility to tailor a capital standard to the business of insurance. We are exercising great care as we move forward with this mandate to determine capital standards that are well tailored to the business of insurance.

The Federal Reserve's role in the regulation of insurers takes place at the enterprise-level. Our principal supervisory objectives for insurance holding companies are protecting the safety and soundness of the consolidated firms and their subsidiary depository institutions or mitigating financial stability risks. The Federal Reserve's consolidated supervision supplements existing legal-entity supervision with a perspective that considers the risks across the entire firm. The Federal Reserve's role in monitoring and mitigating risks to financial stability seeks to ensure, as appropriate, that supervised insurers remain solvent, maintain their positions as financial intermediaries even in times of stress, and are resolvable in a manner that is not destabilizing to the financial system when resolution is required.

The Dodd-Frank Wall Street Reform and Consumer Protection Act authorizes the Federal Reserve to establish consolidated requirements at the holding company level, in addition to the capital requirements that are imposed on insurance companies under individual state insurance laws on a legal-entity basis. We conduct our consolidated supervision of these firms in coordination with state insurance regulators who continue their established oversight of the insurance legal-entities and continue to look for opportunities to further coordinate with them. The supervisory program continues to be tailored to consider the unique characteristics of insurance operations and to rely on the work of the primary functional regulator(s) to the greatest extent possible. We recognize and appreciate the importance of state insurance regulators' mission to protect policyholders. We continue to coordinate with state insurance regulators in their protection of policyholders and aim to avoid replicating their supervision. We do not believe the mission of protecting policy holders which is the primary focus of state insurance regulators and ensuring the safety and soundness of the consolidated firm and mitigating a firm's risk to financial stability which are the primary areas of focus of the Federal Reserve's supervisory program are mutually exclusive propositions.

We have been engaging extensively with the NAIC, FIO, independent experts, regulated entities, and market participants to solicit feedback on capital frameworks that would be consistent with federal requirements.

5. Do you concur with Governor Tarullo's remarks in a recent speech distinguishing between risks facing the life and P&C industries and can further distinctions be made between personal lines P&C activities and more sophisticated commercial exposures?

I agree with the comments Governor Tarullo made in his September 28th speech that acknowledged the importance of looking at the liability structure of firms in determining capital requirements for insurance companies, particularly those involved in a mix of activities. As we approach our domestic rulemaking, we are soliciting input from a wide range of experts, supervisors, and other participants.

It would be premature for me to comment on how we will treat the unique risks of certain insurance lines, mix of business and the like, before staff has finished its research vetting potential options. However, we are committed to a formal rulemaking process in the development of a domestic insurance capital standard.

Questions for Thomas Sullivan, Senior Adviser, Board of Governors of the Federal Reserve System from Representative Rothfus:

1. In a recent speech at a Conference on Financial Regulation at the Banque De France, Federal Reserve Governor Daniel Tarullo, discussed some detailed thoughts regarding capital requirements for various nonbonding entities. For insurers, Gov. Tarullo stated, "the traditional property-casualty insurance model does not appear to raise significant funding, fire sale, or other macroprudential concerns."

"Similarly, the move of some insurance firms into... capital market activities can work significant changes in the balance sheets of those firms, creating tighter connections to the rest of the financial system."

"Thus the liability side of the balance sheets of firms that are all 'insurance companies' can vary substantially... Yet capital regulation currently applicable to insurance companies seems not to make some of the relevant distinctions."

"In confronting these and similar challenges, I would suggest that a focus on the actual nature of liabilities associated with a firm's activities provides a good starting point for sound analysis."

It appears that Governor Tarullo is essentially noting that different insurance companies are involved in different activities, some of which can be riskier than others. Accordingly, instead of just setting capital charges for all insurers like they are the same, capital requirements should be differentiated based on the risk posed. Nowhere does Gov. Tarullo state that the current definition of an Internationally Active Insurance Group (IAIG) - operating in 3 or more countries and deriving at least 10% of your premium from overseas subsidiaries - is the correct barometer to use to determine which firms should be subject to higher capital charges.

Do you agree with Governor Tarullo's statements that regulators should focus on the actual nature of liabilities associated with an insurer's activities? If you agree, would you also agree that the International Association of Insurance Supervisors' (IAIS) proposal to subject internationally active insurance groups (IAIGs) to higher capital standards simply based on the number of countries they operate in fails to meet this test? Is it not more appropriate to base higher capital standards on the products and activities offered by an (IAIG) instead of simply the number of countries an insurer operates in, which is not indicative of additional risk?

In his September 28th speech, Governor Tarullo noted the importance of reviewing the liability structure of insurers in determining capital requirements for insurance companies supervised by the Federal Reserve Board (Board), particularly since insurers' activities can vary substantially. It is important to recall that the process by which an insurer is determined to be systemically important, and the framework for determining capital requirements for such an insurer, are related but distinct. In the framework set out by the International Association of Insurance Supervisors (IAIS), the number of countries in which an insurer operates is one of several factors relevant to determining whether an insurer is globally, systemically significant. The Financial Stability Oversight Council

(FSOC) makes its own independent decisions on designating nonbank financial firms, using the statutory standards set forth in the Dodd-Frank Wall Street Reform and Consumer Protection Act. The IAIS and Financial Stability Board (FSB) use somewhat different standards to make designation decisions than does the FSOC. The international organizations focus on a firm's global systemic footprint and primarily use an algorithm to make their decisions, whereas the FSOC focuses on impact on U.S. financial stability and uses a more judgment-based, firm-specific approach. Furthermore, the number of countries in which an insurer operates is presently not a factor in the IAIS' current framework for capital requirements. As the Board develops the domestic capital rules applicable to insurers that the Board supervises, the Board will assess the appropriate ways to reflect the risks posed by an insurer's activities, assets, and liabilities.

It is also important to note that the standards developed by the IAIS are not binding on the U.S. The Board will evaluate any standard for its appropriateness for the U.S. market, U.S. insurers, and consumers. International regulatory standards cannot be imposed on U.S. firms by an international body; rather, these standards apply in the United States only if adopted by the appropriate U.S. regulators in accordance with applicable administrative rulemaking procedures conducted here. Additionally, none of the standards are intended to replace the existing legal entity requirements that are already in place. The Board continues to focus on constructing a domestic regulatory capital framework for our supervised insurance holding companies that is well tailored to the business of insurance.

Questions for the Record

Requesting Member: Rep. Dennis A. Ross

Hearing Date: September 29, 2015

Hearing Information: Housing and Insurance Subcommittee Hearing on "The Impact of Domestic Regulatory Standards on the Competitiveness of U.S. Insurers"

- Mr. Michael McRaith, Director, Federal Insurance Office, U.S. Department of the Treasury
- Mr. Tom Sullivan, Senior Advisor, Department of Banking Supervision and Regulation, Federal Reserve Board of Governors
- Mr. John Huff, Director, Missouri Department of Insurance, Financial Institutions & Professional Registration
- Mr. Roy Woodall, Independent Member, Financial Stability Oversight Council, U.S. Department of the Treasury

QFRs (for all)

- Currently, the IAIS and its U.S. participants are moving forward with the development of a new High-Loss Absorbency (HLA) capital surcharge for the Global Systemically Important Insurers (G-SIIs). This new proposal was tentatively approved and released on Monday, October 5th. While I am still reviewing this proposal, I am very concerned that this provision was not developed and adopted in the U.S. first before being adopted through the IAIS and FSB.

- Why are we moving forward and rushing to finish this new HLA requirement when our domestic regulators have not created a U.S. SIFI surcharge first? If we are to follow the "U.S. first" approach, shouldn't we first design our U.S. SIFI surcharge before developing a global one at the IAIS? And, furthermore, why are we rushing to develop an HLA to add on top of the Basic Capital Requirement (BCR) when eventually the International Capital Standard (ICS) will replace the BCR and then the regulators will have to entirely redo the HLA anyway?

  I believe that it would be beneficial to step back and carefully consider the current situation. The BCR, HLA, and ICS are all IAIS approaches to require additional capital for insurance companies on a tailored basis. I believe that it would be helpful to more clearly describe in a unified fashion:

  1) the supervisory expectations for each such additional consolidated capital requirement;
  2) the benefits expected from the specific capital requirement and how these benefits differ from the other regulatory requirements; and
  3) the costs that may result from such specific capital requirements .

- Are we abandoning our "U.S. first" approach to meet artificial, unrealistic and unwise political timetables?

As you know, the international efforts in the insurance space are being led on behalf of the U.S. by FIO (Treasury), the NAIC and the Fed. Unfortunately as I indicated in my written testimony, I have been blocked from this "Team USA" by Treasury's FIO and so am not in a position to know more of the details on what went into the creation of these timetable goals. As the State insurance regulators (NAIC) are the primary U.S. insurance company regulators, I believe that it is important that State insurance regulators be on board with any international proposals.

As you know, the FSB designated U.S. insurance companies Prudential Financial and MetLife as G-SIIs, with the consent of its U.S. members to the FSB, including the Treasury Department, before the U.S. FSOC members had reached any decision as to whether either should be a domestic SIFI.

Did "Team USA" agree to the newly proposed HLA before IAIS and FSB approved it? How will this requirement be formally adopted in the U.S.? Will the Federal Reserve do a formal rule making to adopt it on the U.S. Insurance SIFIs? If so, what would be the timing of that rule making? How will a potential factor in the IAIS's stated desire of continuing to change and amend the HLA over the next 4 years?

As stated above, I have not been a participant in "Team USA" even though both our state insurance regulators, the National Association of Insurance Commissioners, and the Board of Governors of the Federal Reserve System indicated to me that they would welcome my participation on the team. A recent GAO report[1] on insurance capital standards verified this exclusion in stating that "U.S. IAIS members disagreed on whether the FSOC independent member with insurance expertise would be a relevant participant in U.S. collaborative efforts". Thus, not being a member of "Team USA", I am unable to fully address your question.

QFRs (Mr. Tom Sullivan, Senior Advisor, Department of Banking Supervision and Regulation, Federal Reserve Board of Governors)

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[1] GAO Report 15-534 "International Capital Standards" published: Jun 25, 2015, publicly released: July 27, 2015, p. 46

- In adopting the Collins Fix, the legislative history makes clear that as generally applied to insurance companies, Fed deferral to state regulatory capital requirements is a viable option. Is it your view that existing state RBC requirements are inadequate as applied insurance companies, and if that is your view, how do you explain why insurance companies overwhelmingly outperformed banks in meeting their obligations during the last financial crisis?

- Do you concur with Governor Tarullo's remarks in a recent speech distinguishing between risks facing the life and P&C industries and can further distinctions be made between personal lines P&C activities and more sophisticated commercial exposures?

Questions for the Record for Mr. McRaith, Mr. Sullivan, Mr. Huff, and Mr. Woodall
House Committee on Financial Services, Subcommittee on Housing and Insurance
"The Impact of Domestic Regulatory Standards on the Competitiveness of U.S. Insurers"
Tuesday, September 29, 2015

Questions for the Record Submission from Representative Rothfus

In a recent speech at a Conference on Financial Regulation at the Banque De France, Federal Reserve Governor Daniel Tarullo, discussed some detailed thoughts regarding capital requirements for various nonbonding entities. For insurers, Gov. Tarullo stated, "the traditional property-casualty insurance model does not appear to raise significant funding, fire sale, or other macroprudential concerns."

"Similarly, the move of some insurance firms into... capital market activities can work significant changes in the balance sheets of those firms, creating tighter connections to the rest of the financial system."

"Thus the liability side of the balance sheets of firms that are all 'insurance companies' can vary substantially... Yet capital regulation currently applicable to insurance companies seems not to make some of the relevant distinctions."

"In confronting these and similar challenges, I would suggest that a focus on the actual nature of liabilities associated with a firm's activities provides a good starting point for sound analysis."

It appears that Governor Tarullo is essentially noting that different insurance companies are involved in different activities, some of which can be riskier than others. Accordingly, instead of just setting capital charges for all insurers like they are the same, capital requirements should be differentiated based on the risk posed. Nowhere does Gov. Tarullo state that the current definition of an Internationally Active Insurance Group (IAIG) - operating in 3 or more countries and deriving at least 10% of your premium from overseas subsidiaries - is the correct barometer to use to determine which firms should be subject to higher capital charges.

Do you agree with Governor Tarullo's statements that regulators should focus on the actual nature of liabilities associated with an insurer's activities? If you agree, would you also agree that the International Association of Insurance Supervisors' (IAIS) proposal to subject internationally active insurance groups (IAIGs) to higher capital standards simply based on the number of countries they operate in fails to meet this test? Is it not more appropriate to base higher capital standards on the products and activities offered by an (IAIG) instead of simply the number of countries an insurer operates in, which is not indicative of additional risk?

Yes. I agree that the focus should be on the actual nature – the economic substance – of insurer liabilities. For example, a variable annuity tied to a benchmark with a guaranteed minimum should be considered very differently than a pure term life insurance obligation, even though both are liabilities. I believe that the focus of the Council should be on the actual and specific activities of companies under review. I further believe that the focus of the Council should be on such activities that, in its judgment, create systemic risk, and that those activities should be clearly identified as such both to the insurer and publicly.

I have been a strong proponent of the idea that the FSOC's focus should be on the activities of insurance companies and other nonbank financial companies. Unfortunately, the majority of the

FSOC has not agreed with me in the past, though the Council has recently shifted by examining non-insurance financial sector activities within the asset management industry.

I do not necessarily agree that a focus on sub-categories of individual firms, whether by geography or size, is inconsistent with an activities-based perspective of macroprudential systemic risk regulation, for the determination standards provided by Dodd-Frank include both size and scope, and elements of geographic range can have an impact on both metrics.

My observation has been that capital standards for different types of financial services firms in the US have been effective. State insurance regulators have the ability under law to require adequate capital for insurance companies, and Congress has repeatedly indicated in legislation its continuing support for the role of the States in serving as the primary regulator for insurance companies. Designing an approach to measure capital adequacy that builds upon the tailored State-mandated risk-based capital framework could serve to enhance the IAIS's perspectives as to G-SIIs and Internationally Active Insurance Groups.

I also believe that it is important to understand that the U.S. system of insurance regulation is quite different from the systems in Europe and other jurisdictions, and that systems that may work well in Europe or Japan , for example, may not be entirely appropriate for the U.S.

Rep. Andy Barr Submission of Questions for the Record
Housing and Insurance Subcommittee Hearing
September 29, 2015
QFR (for all four witnesses: Huff, Woodall, Sullivan and McRaith)

One of the main concerns, I have with the Federal Reserve's work to develop a new capital requirement for insurers under Fed authority, is that I have not heard the Fed clearly articulate the exact concerns it is trying to solve beyond that this was directed by Dodd-Frank and now the Financial Stability Board.

To the panel, what do you believe are the risks, if any, not currently being addressed by state-based insurance capital standards would be corrected by a new Fed standard? What exactly is inadequate with the current state-based standards? This is of particular concern as these entities have not been designated as systemically important financial institutions (SIFIs), but simply happen to be insurers who also own a banking entity. Is there a systemic risk posed by the insurance industry? How would a federal or international capital standard actually moderate that risk?

Thank you for this question Congressman. I too share your main concern.

One of my concerns as to FSOC's designations of insurance companies as SIFIs is that at the time that they were made, there had been inadequate consideration given to the regulatory capital regime to be imposed on those SIFIs.

Instead we had, a "chicken and egg" scenario: the Board of Governors seemed to hesitate in embarking on developing an insurance-tailored regulatory framework until insurance companies had been designated as SIFIs by the Council.

Now, after two plus years, we still do not have regulations proposed for the designated SIFIs and no further clarity as to capital standards for SIFIs or thrift holding companies. During this same time, the Council has not made any recommendations to the Board of Governors concerning the supervision of insurance companies, which the Council is authorized to do pursuant to the its authorities under section 115 of the Dodd Frank Act.

As to non-bank SIFIs, for which the Fed also has authority to set new capital standards, what are your thoughts on simply having the Fed require them to hold a little more capital through an additional surcharge instead of coming up with an entire new regulatory regime for those companies?

I think that your idea to set such a surcharge to establish a further capital buffer at the parent or holding company level is worthy of study and consideration.

Finally, the Fed and FIO are overseas working on an International Capital Standard (ICS) to apply to some U.S. companies that the Fed and FIO have no legal authority to regulate. I am very concerned that the development of an ICS is being done mostly apply European Solvency II-style regulation onto U.S. companies, with the outcome being that our vibrant and diverse domestic industry becoming less competitive. When Congress passed Dodd-Frank, it was decided with a bipartisan consensus that insurance should continue to be regulated at the state level. Never did Congress say, insurance should be regulated through multilateral international forums with no oversight by Congress. Do you agree with this statement? Does Dodd-Frank explicitly direct the Fed to engage in international capital standard rulemaking?

I agree with your statement of Congressional intent.

I believe that a clear, statutory or treaty framework should exist for the United States to participate in efforts to create and establish international regulatory standards. International fora can play an important role in regulatory coordination given the global interconnections of the financial system. However, when such bodies by themselves decide to assume a position of primacy for the domestic regulatory policies of sovereign countries, there will always be concerns that such efforts will go awry, even if they are well intentioned. In my opinion, it is very important that Congress consider a clear statutory framework for the appropriate parameters of such international participation so that they may be aligned with U.S. domestic regulatory authorities established by Congress.

The introduction of capital standards by foreign self-appointed organizations with no legal basis to require domestic regulators to promulgate such standards is inconsistent with our Congressionally-chosen domestic system of prudential regulation of insurance companies by the States. Congress may want to consider whether the scope of Federal efforts to develop and coordinate Federal policy on international insurance prudential matters may have gone too far in displacing authorities that Congress has reserved to the States and State regulators.