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

Before the Committee on Financial Services,
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Thank you Mr. Chairman, Ranking Member and Members of the Committee for inviting PCI and the Westfield Group to testify on "Legislative Proposals to Reform Domestic Insurance Policy".

My name is Joseph Kohmann, Chief Financial Officer and Treasurer of the Westfield Group, which includes Westfield Insurance and Westfield Bank. Westfield Insurance has been in business since 1848 and has had an "A" or higher A.M. Best rating for the past 75 years. Westfield writes property casualty insurance in 31 states and has 1.8 Billion in statutory surplus. Westfield Bank is a five-star "superior" rated community bank by Bauer Financial. We are not a Wall Street Institution, but a very important regional provider of insurance and banking services to Main Street America.

I am testifying on behalf of Westfield and the Property Casualty Insurers Association of America (PCI), which is composed of more than 1,000 member companies, representing the broadest cross section of insurers of any national trade association. PCI members write more than $195 billion in annual premium and 39 percent of the nation's home, auto and business insurance, epitomizing the diversity and strength of the U.S. and global insurance markets.

PCI strongly supports the bills the Committee is considering today to clarify Congressional intent regarding the Dodd-Frank Act and we are very appreciative of the leadership of the Committee and the Republican and Democratic bill sponsors.

H.R. 4510, the Capital Standards Clarification Act of 2014

PCI strongly supports H.R. 4510, the Insurance Capital Standards Clarification Act of 2014 sponsored by Representatives Gary Miller (CA) and Carolyn McCarthy (NY) and 22 other members of Congress. In essence, this bill simply clarifies the original legislative intent of Congress in the Dodd Frank Act that in regulating insurance holding companies with banks or thrift affiliates, the Federal Reserve Board should apply bank capital standards to the banking portion and insurance capital standards to the insurance operations. It is the parallel bill to legislation by Senator Collins to clarify the intent of her amendment in the Dodd-Frank Act that the Board should not be required to impose capital standards designed for bank holding companies on the business of insurance. The Federal Reserve Board has indicated that application of bank holding company capital requirements to insurance companies is inappropriate and has delayed such imposition until Congress can rectify the situation, but the Board has testified that it does not believe it has interpretive flexibility under the Dodd-Frank Act if Congress does not provide relief. While PCI and Westfield and numerous Members of Congress disagree with the Board's limited statutory interpretation, it is essential that Congress address this imminent conflict.

Until 2011, savings and loan holding companies were regulated by the Office of Thrift Supervision (OTS). In 2011, pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), the supervisory responsibilities of the OTS were transferred to the Federal Reserve Board and savings and loan holding companies were subjected to much greater risk supervision, liquidity and capital requirements, not just for the thrifts or banks but also the broader holding company.

The Dodd-Frank Act imposes capital requirements on certain financial companies subject to regulation by the Federal Reserve Board including bank and savings and loan companies and entities such as insurers that have been designated as systemically important financial institutions (SIFIs) by the Financial Stability Oversight Council. These capital requirements may not be less than the capital requirements applied to banks generally, nor quantitatively lower than the bank capital requirements in place on enactment.

Numerous bipartisan members of the House and Senate have written to the Federal Reserve Board that Congress did not intend for the Board to impose bank capital standards on insurers. Senator Collins, the author of this language, has stated in writing to the federal banking regulators that "it was not Congress's intent that federal regulators supplant prudential state-based insurance regulation with a bank-centric capital regime…. [C]onsideration should be given to the distinction between banks and insurance companies…."[1] Federal Reserve Board Chairman Janet Yellen in recent congressional testimony agreed that the imposition of bank capital requirements to insurance groups owning a depository institution was an unintended consequence. Similarly, Board Members Dr. Stanley Fischer and Jerome Powell both testified in response to questions about the application of bank-like capital standards to insurers that there are differences between the bank and insurance models regarding capital needs but that the Board did not have statutory flexibility under the Dodd-Frank Act to accommodate such differences.[2]

H.R. 4510 provides additional flexibility to the Federal Reserve Board to establish appropriate capital standards for insurance companies subject to Board supervision. This important legislation allows the Board to apply strong, insurance-based capital standards to the insurers under its supervision, rather than inappropriate, bank-centric standards designed for banks.

Forcing bank capital standards onto an insurance company makes no more sense than imposing standards designed for auto insurers onto banks. They are fundamentally different businesses, with different risks, leveraging, and regulatory focus. For example insurance capital standards are designed to ensure consumer claims are protected. Federal Reserve Board capital standards are designed to prevent bank runs and protect economic stability as well as protect depositors, and regulate the entire bank holding company. While the Federal Reserve Board needs the ability to protect the soundness of the banking system and appropriately regulate companies under its supervision, this goal is not advanced in any meaningful way by imposing one-size-fits-all bank capital rules on holding companies that are primarily in the business of insurance.

The business and regulatory model of banking is fundamentally different from that of insurers with completely different risk profiles and capital needs. For example, unlike banking, there can be no "run" on the assets of a home, auto or business insurer. Other than payments for a covered loss, the only claim a policyholder can make on the assets of an insurer is for the return of unearned premium if the insured cancels a policy or requests a reduction in coverage – an action that would reduce rather than increase the insurer's net risk. Unlike some bank risks, insurance risks are not correlated with economic cycles. For example the occurrence of auto accidents or

[1] November 26, 2012 letter from Senator Susan Collins to the Federal Reserve Board, Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency.

[2] March 13, 2014 hearing by the Senate Banking, Housing and Urban Affairs Committee.

storms are not correlated with economic downturns, unlike interest rates or lending defaults for banks, so insurance companies can actually provide an important anchor of security and risk diversification for the economy and insurance-bank holding companies. This was demonstrated throughout the recent financial crisis as property-casualty insurers emerged with near record levels of capital despite enduring the economic crisis and several major natural catastrophes.

Insurance companies are currently subject to rigorous, tailored capital requirements at the state level under the state risk-based capital (RBC) system. Risk-based capital was developed by insurance regulators to get away from fixed capital standards in order to tailor requirements based on individual insurer's risk profiles, condition and size. RBC analysis captures risk exposures specific to insurance companies, including asset risk, insurance/underwriting risk, interest rate risk, and business risk. Even within the insurance industry, insurance regulators tailor capital standards very differently for life, property and casualty, and health insurance.

In contrast, the banking capital framework focuses on measuring asset risk and is calibrated by regulators specifically for the asset profile of banks. The risk-weightings for bank assets are often inappropriate for insurance company assets due to the nature of insurance company liabilities, and the fact that insurance companies are significantly less reliant on borrowed debt (especially short-term debt) and therefore do not require the same level of liquidity as banks. Applying a banking measurement to insurance would fail to capture the primary risks while significantly overstating lesser exposures.

False measurements of risk imposed on insurers who happen to have depository institution affiliates do not benefit consumers or the economy in any way. In fact, consumers are already being harmed by the expected implementation of burdensome anticompetitive standards that are being arbitrarily duplicated from one sector and imposed onto a completely different industry, as compliance costs are increasing, capital is exiting the market, and new entrants are scarce, harming jobs, consumers and the economy. This is a poor result for a requirement whose sponsoring author agrees is being misapplied and whose regulator agrees is inappropriate.

While the Federal Reserve Board has acted prudently in delaying imposition of bank capital standards on insurers until Congress can rectify the situation, the potential burdens under the Dodd-Frank Act have already caused numerous insurers to exit the banking industry. Such affiliations can provide important community and customer services and provide additional diversity, competition and capital to the marketplace. Consumers and job growth are harmed if unnecessary regulatory costs force out critical Main Street capital providers.

H.R. 4510 correctly acknowledges that banking and insurance are not the same business, and that supervision of each should reflect their distinct business models. An insurance-based framework is best suited to manage insurance risks and safeguard the ability of insurers to meet their obligations to policyholders. We urge the passage of H.R. 4510 as soon as possible.

H.R. 605, the Insurance Consumer Protection and Solvency Act

PCI strongly supports H.R. 605, the Insurance Consumer Protection and Solvency Act, sponsored by Representatives Bill Posey and Kyrsten Sinema.

Preventing Conflicting Federal-State Liquidation of Insurers

H.R. 605 reflects Congressional intent that insurance company liquidations should continue to be conducted by state insurance regulators and not by the Federal Deposit Insurance Corporation (FDIC) under the Dodd-Frank Act.

Insurance companies are already subject to existing state resolution authority and guaranty funds that protect consumers. State regulators and guaranty funds have more than a hundred years of experience in managing and resolving or liquidating state regulated insurers and their subsidiaries, and it would be inappropriate and create potential conflict to provide for a federal bank resolution corporation to have additional authority to resolve insurers or their non-bank subsidiaries. The Dodd-Frank Act currently allows the FDIC to force a resolution of insurance companies that are part of a failed systemically important financial institution (SIFIs) and the insurer's subsidiaries if a state insurance regulator does not liquidate the covered financial companies within 60 days. The FDIC would "stand in the place" of the state regulator – an odd result that authorizes a bank federal deposit insurance corporation to become a temporary insurance regulator for insurance related insolvencies. H.R. 605 clarifies that an insurance company that is not a bank-holding company or a nonbank financial company supervised by the Federal Reserve Board (a SIFI) or a subsidiary of those entities is not a "financial company" subject to resolution by the FDIC.

Preventing Taking of Insurance Company Assets to Satisfy SIFI Failures

The Dodd-Frank Act currently allows the FDIC, when resolving a failed covered financial company (a SIFI), to reach into certain assets of the SIFI's insurance companies and their subsidiaries. Specifically, section 204(d)(4) of the Act permits the FDIC to take a lien on the assets of a covered financial company or its subsidiaries, but fails to exclude companies and subsidiaries that are insurance companies. State insurance regulators comprehensively regulate insurer investments to ensure that adequate capital and surplus are available to keep the insurer solvent and able to pay claims to policyholders. By giving the FDIC authority to take a lien against insurer assets without advance coordination with state insurance regulators, the Act creates a potential conflict with the ability of insurers to honor claims to policyholders, giving priority to claimants who are not policyholders.

H.R. 605 would bar the FDIC from placing a lien on an insurance company's assets without the written consent of the insurance company's domiciliary state regulator. The bill also makes it clear that the FDIC's authority under Dodd-Frank to place a lien on the assets of certain subsidiaries of a financial firm does not extend to insurance subsidiaries except in limited circumstances. Absent that clarity, Dodd-Frank could allow the FDIC to use insurance assets to cover losses of affiliated banks, even if that would cause the insurer to fail. State insurance regulators enforce strict capital and surplus requirements for insurers to protect policyholders, and the strong state regulation of solvency could be disrupted if federal regulators were allowed to "raid" insurance company assets to shore up other non-insurance affiliates without the approval of state regulators. By excluding insurers from the definition of "financial company," the bill limits the ability of the FDIC to take a lien on an insurance subsidiary.

Double Jeopardy for Insurers

Insurers already have a self-financed resolution system with insurance guaranty funds in every state that assess all licensed insurers in the state as necessary to protect policyholders in the event of an insolvency. In the last 40 years, property-casualty insurers have paid consumers trillions of dollars to fulfill claims and the insurance guaranty funds have provided an additional safety net of more than $21 billion on behalf of insolvent insurers. However, even though insurers are already required to pay into state insurance resolution funds to help ensure that policyholders of other failed insurers are honored, the Dodd-Frank Act allows the possibility that insurers could be held responsible for non-insurance failures, creating a significant one-way subsidy and moral hazard. In fact, insurers could be required to pay for the bailout of a systemically important financial institution (SIFI), and then if the resolution of that SIFI by the FDIC triggers a failure of one of its insurance subsidiaries, the insurance industry would be subject to a second assessment as a consequence of the failure caused by the federal bank regulator.

Because insurers are already responsible under state law for resolution costs within the insurance sector, they should not pay a second time at the federal level for resolution costs outside of the insurance sector. The Dodd-Frank Act does require the FDIC to use a risk-matrix in determining how to assess financial companies, and that matrix does include consideration of an insurer's payments of assessments into state guaranty funds. The matrix, however, does not preclude the FDIC (with federal responsibility for resolving bank insolvencies) from imposing a double resolution assessment on other state-regulated insurers, and the FDIC's assessments are likely to be prior to the timing of a state assessment.

H.R. 605 provides that insurance companies and their policyholders cannot unfairly be made to pay for the resolution costs of other non-insurance financial firms. No non-insurance firms pay into the state insurer guaranty funds. Under Dodd-Frank, certain insurers could potentially be subject to assessments for too-big-to-fail failures and asked to pay for the losses of federally supervised and highly risky and leveraged Wall Street firms, none of which will ever help to pay for insurer insolvencies. Not only would that be unfair, but it would create moral hazards by encouraging other financial entities to engage in risky activities knowing that insurance firms will have to help bail them out if they fail. H.R. 605 corrects this moral hazard.

H.R. 4557, the Policyholder Protection Act of 2014

PCI strongly supports H.R. 4557, the Policyholder Protection Act, sponsored by Representatives Bill Posey and Brad Sherman. This bill prevents federal bank regulators from transferring the assets of state regulated insurance companies and their subsidiaries to a bank if the state regulator determines such transfers would harm the financial condition of the insurer – essentially preventing bank regulators from putting state regulated insurers at risk to rescue banks. This protection currently exists for bank holding companies but was not included in the regulation of savings and loan holding companies under the Dodd-Frank Act.

The Dodd-Frank Act requires insurance companies to serve as a source of financial strength to affiliated depository institutions. Current law requires bank regulators to consult with state insurance regulators before requiring an insurer to serve as a source of strength for a bank

holding company. State regulators can prevent an insurer from serving as a source of strength by providing written notice to the board of the holding company that requiring such insurer to serve as a source of strength would have a material adverse effect on the financial condition of the insurer. However, that protection is not available when the insurer is a savings and loan holding company or is an affiliate of an insured depository institution.

Specifically, under 12 U.S.C. 1831o-1(a), a bank holding company (BHC) or savings and loan holding company (S&LHC) can be forced to serve as a source of strength for an FDIC-insured depository institution (hereafter "depository institution") subsidiary by the "appropriate Federal banking agency". In the case of a BHC or financial holding company (FHC) (but not an S&LHC) that is also an insurance company, under 12 U.S.C. 1844(g) no action by the FRB that requires the BHC or FHC to provide funds or other assets to a subsidiary depository institution is enforceable if the insurer's State insurance authority tells the Board in writing that requiring the insurer to serve as a source of strength would have a material adverse effect on the financial condition of the insurance company.

H.R. 4557 would provide the same protections for S&LHCs with insurance companies as is provided for BHCs – allowing insurance regulators to object to excessive capital transfers from the insurance affiliates to a bank. Specifically, H.R. 4557 would amend section 1831o-1 to provide that the exception in section 1844(g) for BHCs that are insurers will also apply to S&LHCs that are insurers, depository institution affiliates that are insurers, and any other insurer that directly or indirectly controls a depository institution

H.R. 4557 would also clarify more broadly with respect to insurance holding companies with a bank or other depository institution affiliate, whether the holding company is an insurer, an affiliate or controls directly or indirectly a bank, that if the Board requires such insurer to serve as a source of financial strength to the bank, it shall be deemed an `action of the Board that requires a bank holding company to provide funds or other assets to a subsidiary depository institution' for purposes of such section 5(g)' and thus subject to objection by the state regulator.

Insurance consumers should not be put at risk to protect bank investors. Federal bank regulators should not be given authority to take assets from insurance affiliates of banks any more than state insurance regulators should be allowed to demand assets from bank affiliates if either transfer would jeopardize the other entity.

The Insurance Data Protection Act

PCI strongly supports the proposed Insurance Data Protection Act, sponsored by Representative Steve Stivers. The bill makes some important clarifications regarding the appropriate protection on confidential data submitted by insurers to the Federal Insurance Office (FIO) and Office of Financial Research (OFR).

The bill will ensure that confidentiality applicable to information relating to insurance companies is not lost when that information is shared among various federal and state regulators. The Dodd-Frank Act now provides that privileged information retains its privilege when it is submitted to FIO, but it is less clear whether that privilege might be lost if FIO shares it with other federal or

state agencies. For example, Dodd-Frank authorizes FIO to disclose information to state regulators. The regulators would be bound by an information sharing agreement with the government, but a judge might later subject the information from the state regulators to a subpoena, taking the position that the information-sharing agreement applies only to the state regulator or the NAIC and not to the courts. There is no evidence that Congress intended that privileged information should lose its privilege when it is shared with other state or federal regulators.

The bill also limits the duplicative subpoena power of the OFR and FIO. The Dodd-Frank Act gave the OFR and FIO exceedingly broad subpoena powers, granted to federal agencies usually only for purposes of formal administrative proceedings, criminal or civil investigations or Inspector General investigations. The OFR and FIO have none of these functions. No suspicion of criminal or civil violations of a law or regulation is required and no formal administrative proceeding must be initiated. PCI is aware of no precedent for granting such broad subpoena powers to a federal agency in these circumstances. With respect to insurers, the OFR and FIO subpoena power also duplicates the powers that state insurance regulators already have to obtain information and data from insurers, either by subpoena or otherwise. Indeed, the Dodd-Frank Act requires FIO to coordinate with state insurance and relevant federal regulators on information that is available from them, and requires the OFR to "coordinate" with the relevant primary financial regulator. But coordination may ultimately not result in more than mere notification. Similarly, additional statutory considerations required of FIO such as a small business exception are undermined because the scope of such exceptions are ultimately determined by the Director without required approval by Treasury.

The Insurance Data Protection Act would require the OFR and FIO, before exercising such unusual subpoena power, to obtain approval of the Secretary of the Treasury. The Secretary must verify that the data is not available in a timely manner from existing regulators or public sources and to provide appropriate reimbursements as provided in federal regulations. This balance preserves the ability of the OFR and FIO to subpoena information not otherwise available while preventing duplicative and expensive demands that would normally be limited to a regulator or administrative proceeding.

Conclusion

We appreciate the committee's work on these bills and would be pleased to work with members of Congress towards their enactment.