Statement

of

National Association of Mutual Insurance Companies

to the

United States House of Representatives

Committee on Financial Services

Subcommittee on Insurance, Housing and Community Opportunity

Hearing on

Dodd-Frank: The Cost to Insurance Consumers and Investments in Business and the Economy

July 24, 2012

The National Association of Mutual Insurance Companies (NAMIC) is pleased to offer comments to the House Financial Services Subcommittee on Insurance, Housing and Community Opportunity.

We are 1,400 property/casualty insurance companies serving more than 135 million auto, home and business policyholders, with more than $196 billion in premiums accounting for 50 percent of the automobile/homeowners market and 31 percent of the commercial insurance market. We are the largest and most diverse property/casualty trade association in the country, with regional and local mutual insurance companies on main streets across America joining many of the country's largest national insurers who also call NAMIC their home. More than 200,000 people are employed by NAMIC members.

Property/casualty insurance is a fundamental pillar of the United States economy. Its continued functioning is critical to our ability to return the country to robust growth, and it is imperative that we carefully consider any action that might impair the insurance industry's ability to protect individuals and businesses.

To their credit, in crafting the Dodd-Frank Wall Street Reform and Consumer Protection Act ("DFA") [1], legislators recognized that the business of property/casualty insurance was not the cause of the recent financial crisis and that it is unique within the financial services sector. As a result, the industry was not the focus of the new financial regulations that were put in place and was specifically excluded from the purview of the Consumer Financial Protection Bureau. However, the scope of the DFA has led to many changes in how insurance companies – particularly those that are large and diverse – deal with regulation by the federal government. Despite not being the target of much of the new financial services regulatory regime, the DFA has led to an enormous amount of uncertainty for insurers.

We commend the committee for its diligent oversight and review of the DFA and urge Congress to continue its oversight of the federal institutions responsible for implementing the Act. As we move forward, we also urge Congress to move expeditiously to rectify the unintended consequences that are inevitable in any legislative initiative of this size and scope and to hold the agencies accountable for strict adherence to the letter and spirit of the legislation. For the insurance industry, the focus should remain on preventing unneeded and damaging interference in a well-functioning system.

We thank the committee for the opportunity to discuss the critical role property/casualty insurance plays in our markets and share some of our ongoing concerns in a number of specific areas.

---

[1] Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, 124 Stat. 1376 (2010). ("Dodd-Frank")

The Importance of Insurance

Any assessment of the impact of the DFA on the property/casualty insurance industry must begin from an understanding of how the industry interacts with the broader economy as a whole. The constituents of our industry include policyholders (individuals and businesses), taxpayers, insurance companies, agents, and others affected by the insurance underwriting process. All would be impacted by market distortions caused by ill-conceived regulation.

Insurance is simply the transfer of a risk of a loss, from one person or entity to another, 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 failure and personal financial ruin due to natural catastrophe or lawsuit would be dramatically higher, leading to far fewer start-ups and less economic growth. Insurance is the mechanism that has allowed people to take the risks of owning property or starting a business that is critical to the nation's economic vitality.

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. Latest figures show there are 2,689 property/casualty insurance companies currently doing business in the United States. According to the Insurance Information Institute, the property/casualty insurance industry employs upwards of 600,000 people not including agents and brokers.[2]

The importance of the industry in the economic wellbeing of states and local communities can be demonstrated in three major ways. First, insurers are required to pay premium taxes (usually 2 percent of their total direct written premiums) to state treasuries. In 2010, this amounted to $15.8 billion for the entire insurance industry, or $51 for every person in the country. This figure represents 2.2 percent of all state taxes.

Property/casualty insurance companies had $1.3 trillion in cash and invested assets on hand in 2010. Much of this amount is invested in highly liquid securities (stocks and bonds) that allow insurers to quickly turn the securities into cash if they are suddenly faced with paying claims as a result of a catastrophic event. Through a significant portion of these 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. The property/casualty insurance industry invested $331billion in such bonds in 2010.[3]

A final way that insurers contribute to their local communities is through their charitable giving. In 2010, property/casualty insurance companies contributed a total of $500

---

[2] http://www.iii.org/facts_statistics/careers-and-employment.html
[3] Board of Governors of the Federal Reserve System, June 7, 2012

million to charities, 80 percent of which came through direct cash contributions. The remainder represented employee cash donations and volunteer hours. About a third of the money went to support educational endeavors.

Over the last several years the property/casualty insurance industry has withstood the challenges of the financial crisis and weak economic recovery, as well as severe catastrophe losses. Last year ranked as the fifth most expensive year recorded for insured catastrophe losses, totaling $33.5 billion in the United States alone.[4] Profits dropped by about one half for the industry between 2010 and 2011 simply from the underwriting losses experienced.

Despite all that, the property/casualty insurance market remains highly competitive and well-capitalized with surpluses exceeding pre-financial crisis highs. 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 in place, 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.

As an example of such a business model, one of the common threads that bind NAMIC members together is our 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 their quarterly earnings report.

Uncertainty in the Insurance Market

The state-based system of insurance regulation was left largely intact by the DFA. Entirely new regimes were not created to focus on the property/casualty insurance industry. Yet that did not prevent the legislation from creating uncertainty regarding the future regulatory environment.

Office of Financial Research

The DFA created the Office of Financial Research ("OFR") within the Department of the Treasury and charged it with conducting financial analysis in support of the FSOC, looking at ways to standardize financial reporting requirements, developing a reference database, making financial data efficient and secure, and producing regular reports to Congress on threats to the financial system and its key research and findings.

[4] http://www.iii.org/articles/2011-year-end-results.html

The jurisdiction of the OFR is vague and there is potential for the office to grow beyond its scope as an information clearinghouse. In addition, the OFR has almost unlimited power to subpoena financial companies – including insurers – for information. The OFR raises concerns for insurers regarding duplicative calls for information, standardization and presentation of data, and confidentiality of information. Insurers have additional concerns regarding the type of information to be presented in the "publicly accessible database." Without context, this type of public information could be misleading and could pose concerns regarding confidentiality and proprietary information..

Insurers, like other financial institutions, will also be assessed new fees to fund the work of the OFR. There is legitimate concern that the assessment base used will not appreciate the difference in financial structure between banks and insurance entities and assessments will not apply fairly between all financial institutions.

Insurers have concerns over the size and scope of the OFR and the unchecked ability to expand and impose additional regulatory and expense burdens on insurance companies and their customers. NAMIC believes that sufficient, high quality information on the insurance industry is collected, analyzed and maintained by state regulators and that additional information collection, analysis and dissemination by the OFR is unnecessary.

Consumer Financial Protection Bureau

In the legislative language of the DFA, all lines of property/casualty insurance were expressly excluded from the jurisdiction of the Consumer Financial Protection Bureau. To date the bureau has worked within that jurisdiction. For example, NAMIC raised concerns with the construction of the complaint database and requested that insurance related complaints be excluded. We are pleased that the CFPB accepted our recommendations and constructed the online complaint database to direct anyone with an insurance complaint directly to the corresponding state regulator.

However, we remain concerned there are multiple avenues that the CFPB might pursue which would needlessly sweep the property/casualty industry under its regulations. NAMIC is concerned that the CFPB could seek to assert supervisory control over insurance company operations – which were explicitly excluded from its jurisdiction – by redefining insurance companies as other types of financial operators. Such an outcome is inconsistent with congressional intent and would disrupt the functional regulatory balance.

Federal Insurance Office

Although the Federal Insurance Office ("FIO") is meant to be a source of information and expertise and not a regulator, it was granted the authority to subpoena insurance companies for information as well as preempt state law for the purposes of complying

with international trade agreements. While it may be a rare occurrence when the FIO utilizes either of these powers, the fact remains that the office has them and it leads to further uncertainty about future regulation and compliance. NAMIC commends the committee for continuing to seek reassurances that FIO understands that its role is to monitor the insurance industry, not to regulate it, and to resist efforts to expand the authority of the office to supervisory functions. We also continue to urge FIO Director Michael McRaith to utilize his office to monitor the work of federal financial regulatory agencies and educate these agencies about the differences between insurance and banking, ensuring that federal regulatory proposals properly respect the authority of the states to regulate the business of insurance.

Volcker Rule

Section 619(a) of the DFA prohibits banking entities from engaging in proprietary trading and from investing in or sponsoring hedge funds and private equity funds. Congress recognized the importance of appropriately accommodating the business of insurance and provided an exemption from the Volcker Rule for an insurance company acting on behalf of its general account. Section 619(d)(1)(F) provides that, notwithstanding the prohibitions of Section 619(a), investing in "securities and other instruments described in subsection (h)(4) by a regulated insurance company directly engaged in the business of insurance for the general account of the company and by any affiliate of such regulated insurance company" is a permitted activity.

Further, Dodd-Frank mandated that the Financial Stability Oversight Council ("FSOC") study and make recommendations on implementing the Volcker Rule to "appropriately accommodate the business of insurance within an insurance company, subject to regulation in accordance with the relevant insurance company investment laws, while protecting the safety and soundness of any banking entity with which such insurance company is affiliated and of the United States financial system."

Despite this clear direction, the complexity of legislative language and the absence of a final rule have generated unnecessary uncertainty about whether investment limitations will in fact be imposed upon property/casualty insurers affiliated with an insured depository institution. Straying from the legislative intent to accommodate insurers would have the unintended consequence of severely restricting investment options, including ones that involve minimal risk. Allowing insurers to continue in their normal regulated investment activity from their general account, including engaging in proprietary trading and owning private equity and hedge funds, is essential to allow insurers to appropriately engage in effective investment strategies, including matching investment portfolios to anticipated liabilities.

A number of changes will be necessary in the proposed rules to ensure that the application does not jeopardize insurance company operations, including investments in

covered funds, the use of separate subsidiaries and participation in compliance programs.

With respect to covered funds, there is a concern as to whether the insurance company exemptions for proprietary trading apply to such investments. Covered funds include traditional hedge funds, private equity funds, and other funds such as certain foreign funds and commodity pools. The legislative history of Dodd-Frank shows that Congress clearly intended to exclude insurance company activities from the scope of the Volker Rule prohibitions on investments in covered funds.

Insurance companies invest in covered funds for the same reasons they invest in other types of assets – to ensure a sound investment strategy that will facilitate policy performance over the long-term, to effectively diversify portfolio holdings, and potentially earn higher returns. The ability to diversify an insurance company's investments is important to creating a balanced portfolio. Covered funds, provide a means by which companies can reduce correlation risk as they are less highly correlated with traditional stock and bond investments because of their short-term trading strategies. Investment in covered funds permits insurance companies to properly align both income streams and asset class durations with liabilities. The ability to engage in such investment is critical for insurance companies with long-tail policies in which the liability for coverage may not arise for a significant period of time. Lastly, covered funds provide insurance companies with access to high quality assets with potentially higher rates of return than other traditional assets.
Restricting the ability of insurance companies to utilize these investment asset classes would frustrate prudent long-term investment planning and introduce competitive disadvantages for insurance companies affiliated with depository institutions. It would be economically punitive for insurers if their investment trading were restricted so that they could no longer utilize their long-established basic business models. Therefore, in compliance with congressional intent and to protect the financial stability of insurance companies it is essential that the agencies amend the proposed rule to include General Account and Separate Account Exemptions for acquisition or retention of ownership interest in a covered fund by a covered banking entity that is an insurance company.

In addition to investing in covered funds, various state insurance laws allow an insurance company to invest in, or organize subsidiaries which may invest in, instruments on behalf of the parent insurance company. Under Section 13(d)(1)(F), affiliates of regulated insurance companies are permitted to purchase, sell, acquire, or dispose of assets for the general account of the regulated insurance company. Because such investment activities are specifically permitted, it would be inconsistent to deem the affiliate a covered fund sponsored by the insurance company, an activity prohibited under the Volcker Rule. Insurance companies should be allowed to organize or invest in wholly-owned subsidiaries or affiliates for the purpose of making investments, as permitted under applicable state insurance law, without that subsidiary being deemed a covered fund. Also, insurance company subsidiaries established under state insurance law should be specifically excluded from the definition of "covered fund." Such exemptions are consistent with the logic of the proprietary trading exemption and

the legislative intent of Dodd-Frank that the agencies accommodate the business of insurance.

Lastly, the proposed implementation of the Volcker Rule requires compliance with detailed reporting and recordkeeping requirements. These reporting and recordkeeping requirements are unnecessary in the context of insurance companies. State regulated insurance companies comply with strict investment laws that specify which types of assets domestic insurers may hold. Many of these state laws also prescribe limits on the amounts of each type of asset that an insurer may hold, as well as limits on the amount of investments in a single issuer that an insurer may hold. Additional state laws typically require the adoption of a written investment plan, including standards for the acquisition and retention of investments by the insurance company and oversight by its Board of Directors. State insurance laws also ensure that investments are valued correctly. The National Association of Insurance Commissioners' ("NAIC") accreditation standards, require that securities be valued according to the rules of the NAIC's Securities Valuation Office[5] and that other invested assets be valued according to the rules of the NAIC's Financial Condition (E) Committee.

In addition, state insurance regulators provide effective enforcement of the stringent financial and investment requirements. The NAIC's Model Law on Examinations, adopted in essence by nearly every state, requires each state's insurance department to conduct an on-site examination of each company domiciled in that state every three (in older versions of the law) or five years. Full- scope examinations are extremely thorough and include review of management and internal controls, corporate records, accounts, financial statements, and asset quality.

Dodd-Frank recognizes the validity of state insurance law and regulation unless the Federal banking agencies make a showing otherwise. Based on the breadth and quality of the state reporting and examination process and the statutory recognition of the state regulatory system, it is appropriate to exempt insurers from reporting and recordkeeping requirements of the Volcker Rule, including the compliance program requirements.

Failure to include an exemption for insurance operations, allow investment in covered funds and continue the use of qualified subsidiaries will subject these companies to costly and duplicative regulation and reporting requirements and thwart the sound investment practices designed to ensure solvency and stability in insurance markets. Our view is supported by the recent statement of the House Appropriations Committee that "the Committee believes that the traditional investment activities of state-regulated insurance companies for their general accounts, including investing in both sponsored and third-party funds, are preserved by the law without constraint." We urge the House Finance Service Committee, as well as the Appropriations Committee, to ensure that the revised regulations fulfill Congressional intent.

---

[5] The SVO is a NAIC staff office that assigns asset quality designations (NAIC-1 for the highest quality, through NAIC-6 for obligations in default) and valuations.

The Federal Reserve

Before the passage of the DFA, 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 in the DFA and the Federal Reserve Board (the "Federal Reserve") was given responsibility for holding company 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. To successfully incorporate insurance-connected SLHCs into its supervisory regime, it is imperative that the Federal Reserve recognize the striking differences between the activities of many of the bank holding companies ("BHCs") traditionally regulated by the Federal Reserve and a number of insurance-connected SLHCs that will be supervised in the future.

These distinctions include significantly different financial reporting, accounting standards, capital requirements, and other operational activities. The information and standards that are critical to supervising a SLHC which is overwhelmingly engaged in insurance activities is fundamentally different than the information and standards critical to regulating traditional BHCs. The risk and exposure of insurance companies and the nature and utilization of their assets and liabilities can be significantly different from banks.

The Federal Reserve should fully recognize the distinct regulatory approaches required to properly supervise banks and insurance companies which entail different measures for capital, financial strength, and stability. In other words, it is not appropriate to mandate an accounting practice that is akin to fitting a square peg of information into a round regulatory hole. One size does not fit all, and consequently, the system of supervision should be tailored to this economic reality.

Unfortunately, notwithstanding a genuine effort to understand the business of insurance, the Federal Reserve continues to take a bank-centric approach to regulation making little allowance for insurance specific standards. For entities new to the Federal Reserve regulatory process that are still trying to interpret the meaning of bank-centric requirements, there is frequently insufficient time to process and respond to comment periods for new rules and regulations. Frequently, there are real and significant concerns that need to be addressed. The practical result of some regulations may not be immediately apparent and the Congress should urge the Fed to go slow and work closely with the insurance companies it now oversees. Furthermore, rather than working with state regulators and relying on the professional expertise of the functional regulators, the Federal Reserve is engaging in detailed investigations into insurance company operations. Such activities are duplicative, time-consuming, and costly for both the government and the insurance company, and could lead to conflicting determinations between regulators and inappropriate decisions.

Capital Standards

One of the greatest challenges some of our companies face today are proposed capital standards for SLHCs engaged predominantly in the business of insurance. The capital structures and regulatory treatment of bank and insurer capital are markedly different because their respective business models are different. In simplest terms, banks take deposits and lend those deposits to others in the form of loans. Since depositors always have the right to call in their deposits, banking capital regulation is focused on asset quality and liquidity to meet depositor demands. In contrast, an insurance consumer pays premiums for a contractual promise to pay for a covered loss—such as an automobile accident. The insurer does not lend out those premiums, but uses them to pay claims and invests them to match expected liabilities. Insurance regulation is focused on liabilities, ability to pay claims as they come due, and regulating capital in manner that matches assets to liabilities. Naturally, banking regulation has developed and evolved around entities engaged predominantly in the business of banking—with recognition in recent years that some banks may also have a relatively small insurance operation.

While Congress authorized the Federal Reserve to set capital rules for SLHCs, the requirement for capital rules and consistent standards doesn't change the fact that many SLHCs are very different than BHCs.

We understand that the Federal Reserve has an extraordinarily difficult task in developing multiple rules under DFA and in addressing areas and companies not previously under their jurisdiction. We appreciate the difficulty of the task ahead; however, the desire for expediency should not overshadow the fundamental differences inherent in the business structures.

As such we are particularly concerned that in trying to fulfill their obligations, particularly as it related to international banking standards under Basel III, the Federal Reserve proposed new capital rules for all banks, BHCs, and SLHCs. The June 7th proposed rules represent a one-size fits all approach that simply does not make sense for an SLHC engaged predominantly in the business of insurance.

The application of these capital requirements to mutual insurance SLHCs will have many significant consequences. It will require many mutual insurers to adopt new accounting practices. It will not fully recognize forms of capital that state insurance regulators have recognized for more than a century, like surplus notes. It will result in unintended and unwarranted differentiation between stock and mutual insurers who own banking organizations. And it will result in significant disruption in business functions in advance of the 2013 effective date of the rules. This is obviously not a consequence that Congress intended.

Under DFA, as passed by Congress, more time for the transition for SLHCs could have been provided, but the Federal Reserve chose to start the implementation process for all banking organizations in 2013. In comparison, when Basel I capital requirements were initially proposed in 1989, banks and their holding companies, who were already subject to Federal Reserve capital requirements and already under GAAP accounting, were given three years to comply with the new capital structure.

We will urge the Federal Reserve to consider accepting equivalence of the capital standards required by state regulators. If they must have a one-size-fits-all capital process then at a minimum they should allow the full three years for insurance-connected SLHCs to adopt new accounting practices and adjust to the new bank-centric requirements. At a bare minimum the Federal Reserve needs to provide more time for all interested parties to assess the proposed capital requirements and provide well-researched comments applicable to the proposed rule.

We consider it a good sign that while testifying before Congress last week, Chairman Ben Bernanke indicated that the Federal Reserve would work to recognize the differences between insurance and banking holding companies. In this light, we believe the Federal Reserve should recognize state risk-based capital models as providing a foundation that can be deemed sufficient to satisfy the minimum risk-based capital and leverage requirements of the Collins Amendment.

Systemic Risk

Throughout the debate on regulatory reform, we have consistently pointed out that traditional property/casualty insurance products and services do not pose systemic risk and the legislative history of the DFA is unambiguous that Congress agreed with us on this point. However, we continue to face challenges from federal regulatory agencies attempting to establish bank-centric standards and thresholds, which could inappropriately result in the designation of an insurer as systemically significant.

The DFA tasks the Financial Stability Oversight Council (“FSOC”) with identifying those financial institutions that might pose a systemic risk to the U.S. economy. Any company – including non-bank financial institutions such as insurance companies – that is designated by the FSOC as a Systemically Important Financial Institution (“SIFI”) will be subject to heightened capital standards and regulation by the Federal Reserve. NAMIC worked with the FSOC to ensure that the six-category analytical framework - size, interconnectedness, lack of substitutes, leverage, liquidity risk and maturity mismatch, and existing regulatory scrutiny - takes into account insurance specific standards and regulatory structures. While we were generally pleased with the final criteria, we note that the FSOC rejected an industry wide exception for insurance companies.

However, the Federal Reserve recently proposed a regulation to apply those same SIFI standards to any banking organization with over $50 billion in assets and with substantial banking activities, regardless of FSOC designation. NAMIC believes that this arbitrary numerical threshold set by the Federal Reserve is contrary to congressional intent and ignores the unique nature of certain financial products,

including property/casualty insurance. The application of heightened capital standards – again, designed with banks in mind – to insurance companies would be unnecessary and inappropriate.

We are concerned also about the confidentiality of information submitted during the designation process. The final rule indicates that information collected, from whatever source, during FSOC's analysis is subject to the Freedom of Information Act (FOIA), including its exceptions. The rule further states that submission of privileged materials to the FSOC does not waive any applicable privilege, but we remain concerned, absent statutory support, that this may not provide adequate protection. For example, the Federal Deposit Insurance Act provides for such protection for materials provided to enumerated federal bank regulatory agencies. The FSOC, however, is not among those enumerated entities. The CFPB recently attempted to address concerns by promulgation of a rule asserting its ability to protect information it receives. In addition, NAMIC is concerned that members of the FSOC may share information among themselves that is derived from their respective agencies and elsewhere. Although the protection from public disclosure of such materials is intended to travel with the materials, the FSOC members may share the information with their own agencies for enforcement or other purposes, thus expanding the use of such materials for other purposes. NAMIC supports passage of H.R. 4014/S. 2099 to ensure that information submitted to the CFPB remains privileged under both the attorney-client and work product privileges as well as other protections that would guarantee that materials are used only for the intended regulatory purpose, not released and that the documents retain their attorney-client and work product privileges.

Resolution Authority

The state-based resolution authority for insolvent property/casualty insurers is a thoughtful, methodical process with a superb track record of protecting insurance claimants and policyholders. The state-based guaranty fund system is designed first and foremost to protect policyholder and third-party claimant interests. Each state provides for priority of these claims over other unsecured general creditor claims. In addition, unlike federal resolutions of banking interests, insurance company resolutions require adjustment of property/casualty insurance claims dependent on state law and requiring detailed and specialized knowledge.

Subjecting insurance companies, including mutual insurance holding companies, to federal resolution would disrupt this well-functioning system. Overlaying federal resolution would needlessly complicate the process and likely disadvantage policyholders and claimants. NAMIC is pleased that the Federal Deposit Insurance Corporation recognized the strength of the state-based resolution system and clarified that insurance operations will be resolved under state insolvency laws. Further, NAMIC believes that the FDIC properly recognizes mutual insurance holding companies as insurance companies. Such treatment is consistent with legislative intent and best serves insurance policyholders and claimants. The proposed criteria are appropriate to identify a *bona fide* mutual insurance holding company and consistent with the goal of

conforming state resolution authority for insurance companies with the resolution authority of the holding company.

There is still significant concern that any company above $50 billion in assets – including mutual holding companies or SLHCs could be subjected to an assessment in the event that a federal bailout is needed to unwind a SIFI after failure. This also raises the concern about the appropriate assessment base. Any base used for all financial institutions will need to address the differences in financial structure between banks and insurance entities. More fundamentally, subjecting insurance companies to an assessment to pay for a mechanism that they will not need or likely ever make use of would be inherently unfair.

Accounting Standards

Of particular concern to insurers is the ability to prepare financial statements in accordance with Statutory Accounting Principles ("SAP"). State regulators – and previously the OTS – accept and use SAP financial statements as opposed to requiring such statements be prepared using Generally Accepted Accounting Principles ("GAAP") for both subsidiary and holding company reporting purposes. Switching the type of reporting from SAP to GAAP for those holding companies regulated by the Federal Reserve either because of bank-oriented reporting forms or due to international pressure is simply not justified by the resulting costs and burdens that would be imposed on companies.

All insurance companies in the United States are required for state regulatory purposes to report based on SAP (publicly held insurers are also required to report on a GAAP basis). The important difference between GAAP and SAP is the purpose of each system. One of the primary objectives of GAAP accounting is to provide important financial information to the investing community to make informed decisions on a going concern basis regarding whether to invest in publicly traded companies. In contrast, SAP reporting was designed from the outset with a solvency focus and regulatory purposes in mind (monitoring for solvency and financial soundness) and has a long history of highly effective use in the insurance sector. It provides appropriately conservative measures of insurance assets and liabilities. The use of SAP is codified in all states because its more conservative approach in assessing an insurance company's solvency and ability to pay claims, and meet its obligations is the very foundation of financial entity regulation. SAP is also well recognized within the accounting profession as an Other Comprehensive Basis of Accounting ("OCBOA") and like GAAP, also allows for audited financial statements.

Most important from our perspective is that numerous non-publicly traded insurers, such as mutual insurance companies, use SAP exclusively or use GAAP only on a limited basis. Consequently, if the Federal Reserve requires the application of consolidated GAAP-based accounting solely for purposes of reporting on the FR Y-9, the transitional costs will be extraordinary, requiring changes in accounting systems, internal control systems, and training of personnel, thereby creating significant burdens without

providing any appreciable benefit in meeting the regulatory goals of safety, soundness, and identifying risks in the holding company. Furthermore, although the burdens are significant for both small and large insurers, they would be particularly acute in instances where the thrift is a relatively small component of the larger insurance holding company and further amplified in large insurance companies with relatively small thrifts. Finally, the significant costs associated with implementing GAAP solely for SLHC reporting purposes, would not obviate the need to continue preparing reports on a SAP basis, which would have to be continued for state regulatory purposes.

Given these considerations, NAMIC does not believe any perceived benefits to the Federal Reserve or to companies in mandating the use of GAAP are justified by the costs. Furthermore, a SAP based reporting requirement would better align with the needs and stated purpose of the Federal Reserve to determine the safety and soundness of the insurance-connected SLHC. The burdens associated with requiring GAAP-based reporting on SLHC's not otherwise required to produce consolidated GAAP statements would be significant and could have adverse consequences, particularly in instances in which very large insurance operating companies own relatively small thrifts.

Conclusion

It is clear that the property/casualty insurance industry plays a key role in the economy and every effort should be made to ensure that its markets are functioning. Unfortunately, even though the industry was not directly targeted, the DFA has created a large amount of potential market turmoil and uncertainty for insurers. NAMIC again thanks the committee for its careful attention to our concerns and for its continued scrutiny of the implementation of the DFA. As we move forward, we would urge Congress to rectify the unintended consequences that are inevitable in any legislative initiative of this size and scope. The focus should remain on preventing unneeded and damaging interference in a well-functioning system.