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U.S. CHAMBER OF COMMERCE

Statement of the U.S. Chamber of Commerce

ON: "The Impact of Dodd-Frank's Insurance Regulations on Consumers, Job Creators, and the Economy"

TO: The Subcommittee on Insurance, Housing and Community Opportunity

DATE: July 24, 2012

The Chamber's mission is to advance human progress through an economic, political and social system based on individual freedom, incentive, initiative, opportunity and responsibility.

The U.S. Chamber of Commerce is the world's largest business federation, representing the interests of more than 3 million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations.

More than 96 percent of the Chamber's members are small businesses with 100 or fewer employees, 70 percent of which have 10 or fewer employees. Yet, virtually all of the nation's largest companies are also active members. We are particularly cognizant of the problems of smaller businesses, as well as issues facing the business community at large.

Besides representing a cross-section of the American business community in terms of number of employees, the Chamber represents a wide management spectrum by type of business and location. Each major classification of American business -- manufacturing, retailing, services, construction, wholesaling, and finance – is represented. Also, the Chamber has substantial membership in all 50 states.

The Chamber's international reach is substantial as well. It believes that global interdependence provides an opportunity, not a threat. In addition to the U.S. Chamber of Commerce's 115 American Chambers of Commerce abroad, an increasing number of members are engaged in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Positions on national issues are developed by a cross-section of Chamber members serving on committees, subcommittees, and task forces. More than 1,000 business people participate in this process.

Chairman Biggert, Ranking Member Gutierrez, and members of the Insurance, Housing and Community Opportunity Subcommittee, I am Thomas Quaadman, vice president of the Center for Capital Markets Competitiveness at the U.S. Chamber of Commerce. The Chamber is the world's largest business federation, representing the interests of more than three million businesses and organizations of every size, sector and region. I appreciate the opportunity to testify before the Subcommittee today on behalf of the businesses that the Chamber represents.

The series of hearings this month, by the Financial Services Committee and its Subcommittees, on the second anniversary of the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), provide us with an opportunity to take stock of the framework and progress of this landmark legislation. Much of the testimony provided during these hearings has focused on what the Dodd-Frank Act does or intends to do. While I will get to the impacts of the Dodd-Frank Act particularly upon the insurance and business community in a minute, I do want to spend some time discussing what the Dodd-Frank Act does ***not*** do.

The need for financial regulatory reform was apparent before the 2008 financial crisis. Over the last decade it became evident to many observers that the U.S. capital markets, the deepest and most efficient in world history, were slowly but consistently losing their edge. This was making it more difficult and expensive for businesses to raise the capital needed to grow and create jobs. In 2006, the Chamber formed a bi-partisan commission headed by Bill Daley and A.B. Culvahouse to research the problem. After a year, they came back with two conclusions: 1) that our international competitors were competing using our game plan—not a bad thing; and 2) that our financial regulatory structure, which dates from the New Deal and in some cases as far back as the Civil War, was ineffective, overly complicated, and inadequate to deal with a 21st century economy. Others, from Mayor Michael Bloomberg and Senator Charles Schumer to Harvard Professor Hal Scott, reached similar conclusions at around the same time.

Such an antiquated, static system froze regulators' capabilities at the time they were created or endowed with their powers. At best, regulators were trying to regulate 2007 markets with 1975 regulatory tools. As a result, regulators had not kept pace with and did not understand the markets or products that they were trying to regulate. This led to confusion amongst regulators, turf battles, regulatory gaps and dead-zones, layering of rules, and a difficulty for regulators to deal with cross-border issues on an international basis. As was evidenced by the Madoff and Stanford cases, regulators could not spot the bad guys and drive them out of the markets.

In short, businesses did not have clear rules of the road, regulators were inconsistent in enforcing those rules, and bad actors were not found or punished. This was not a formula for success.

Common sense solutions—streamlining the number of regulators, hiring the expertise needed to understand the markets, making the regulators accountable, forward looking regulation—were not considered in the Dodd-Frank debate. Instead, Dodd-Frank creates more regulators, exponentially increases layering and overlap, and does not hold regulators accountable. The Dodd-Frank Act adds more floors to a building sitting on a crumbling foundation.

In a sense, the Dodd-Frank Act tries to super-size the 1975 system while the regulators should be thinking on how the markets will look in 2020.

MF Global and Peregrine are just the latest indicators that the underlying foundational issues remain. Because of the failure to address these underlying issues and the regulatory explosion under the Dodd-Frank, our financial regulatory structure is in danger of becoming even more inefficient, while constraining the ability of non-financial businesses to grow and thrive. Simply, we may be in danger of jumping from crisis to crisis with a sluggish economy to boot.

The financial services industry is a conduit to provide a transfer of capital from investors to businesses. Unreasonably restricting that conduit affects the ability of businesses to tap the capital they need to operate and grow. Our economy is in fact a rich and diverse mosaic with no one part being the same as another.

The insurance industry is a unique and important part of that mosaic.

The insurance industry is one of the largest investors in the world. Insurance companies can be direct investors in companies through the purchase of bonds or equity instruments, or they can invest in entities that support businesses, such as commercial real estate. Furthermore, because of the insurance industry's need to match its investment portfolio to the very long-term nature of many of its products, it is by nature and necessity a long-term investor committed to the long-term growth and productivity of the companies or products in its asset portfolio. As a result, it is in the best interests of insurers to be extremely prudent in their risk taking.

Therefore, insurers, besides the risk management services they provide to their customers, are a critical piece of the capital markets. Insurers are a key provider of capital for the long-term. Consequently, the potential adverse impacts of the Dodd-

Frank Act upon the insurance industry's ability to act as an investor will have serious consequences for Main Street businesses.

Dodd-Frank also has consequences unique to the insurance industry. Asset liability management for insurers is by its very nature a form of proprietary trading. While this trading is done for the benefit of the insurance company, the ultimate beneficiaries are the policy holders who will receive the benefits of coverage should the underlying circumstances—a car accident, home fire, loss of income due to death or disability—arise. Congress recognized this issue and wisely provided insurance companies with an exemption from the Volcker Rule.

However, as Dodd-Frank gives with one hand it also takes away with the other.

Insurers that own banks are not exempt from the Volcker Rule. Insurance companies may own a bank for a variety of reasons—like lowering transaction costs or providing additional services to customers. Several insurance companies have already spun off their banks to avoid being entrapped in the Volcker Rule. So while these insurance companies do not engage in the type of proprietary trading envisioned by the Volcker Rule and were intended to be exempted by Congress, they are still forced to make business decisions based upon regulatory interpretations that make them less efficient.

Even if insurance companies are completely exempt from the Volcker Rule, the subjective trade by trade regulatory scrutiny of market making and underwriting practices may make it more difficult for insurance companies to play their traditional role in the debt and equity markets. This will make risk management more difficult for insurance, while reducing the capital formation opportunities and increasing the costs for non-financial companies. This is not an unfounded fear. Federal Reserve Governor Daniel Tarullo testified before the House Financial Services Committee on January 18, 2012, months after the Volcker Rule regulations were proposed, and said that the regulators do not understand what normal market making and underwriting practices are.

If regulators don't know what they are regulating, how can they write a regulation? Therefore, through enforcement or by decision, market participants such as insurance companies may be shut out of traditional investment opportunities or face higher costs and regulatory scrutiny.

Another quandary for regulators and the insurance industry is the designation and regulation of Systemically Important Financial Institutions (SIFIs).

While the vast majority of insurance companies will not fall within the scope of systemic risk regulation and orderly liquidation authority in Title I and Title II, it is worth noting that such a designation would be problematic for insurance companies.

The Federal Stability Oversight Council has finalized regulations laying out the process for designation of nonbank SIFIs. While these regulations provide some insight into the process of being designated as a SIFI, they provide no clarity on the impact of that designation in the marketplace. The Treasury and the Federal Reserve continue to offer no assurance or insight on the market impact on the companies designated as SIFIs, and maybe more significantly, the impact on those companies not designated.

What is clear is that designation brings significant new regulation and supervision of nonbank SIFIs by the Federal Reserve. SIFI regulation and Orderly Liquidation Authority are bank-centric and fail to take into account the different business models that exist within the non-bank world and the insurance industry specifically. For instance, because insurers' liabilities are contingent, runs on capital are not possible, making insurance a major stabilizing force in times of economic distress. Moreover, insurers are typically leveraged at a ratio of around 3-to-1, much lower than that of the banks upon which the rules were formulated. The imposition of bank-centric regulation could cause regulatory mismatches that may conflict with insurance regulations that have been developed for well over 150 years. Regulatory conflicts of this nature will increase risk within the industry rather than temper it.

The Federal Reserve should propose and adopt regulations that are specifically written for the supervision of nonbank financial companies that are designated as SIFIs, including insurance companies. Its current approach of simply applying the same Enhanced Prudential Standards and "tailoring" the application of those rules during the supervision process is unwise and insufficient. It creates unnecessary uncertainty for the regulated entities and potential market distortions. The Federal Reserve can avoid these problems by taking the time to understand how the business models and operations of insurance companies and other nonbank financial companies differ from banks and issuing regulations with the opportunity for public input that reflects these differences. This is too important not to get right at the start.

Through its use of assessments, Orderly Liquidation Authority will spread the risk of a systemically risky company going out of business upon all designated companies. This is the traditional means of dealing with a bank failure, part of which also allows the merger or combination of a failed bank with a solvent bank. So while banks bear the costs, they also have the potential for opportunities that may be profitable.

Traditionally with non-financial companies and insurance, it is the owners of the companies that bear the risk of loss. If those owners and managers no longer solely hold that risk, will a systemic risk designation make them more willing to engage in risky behavior placing their competitors at a disadvantage? This is a known unknown at this point, but one that may be terribly harmful when the answer presents itself in the future.

Also, systemic risk regulation is being implemented globally as well as domestically, in two separate and uncoordinated processes, following different standards with potentially different outcomes. An insurer deemed not systemically risky under the domestic process may still find itself designated under the international process. Moreover, if domestic and international designations carry with them conflicting systemic risk rules, which regulatory regime prevails? Insurance companies designated as systemically risky will bear the brunt of the state regulatory system, domestic systemic risk regulation and international systemic risk regulation. This is not only burdensome and expensive, but it may lead to irresolvable dilemmas that place the company at legal and financial risk.

It should also be understood that these Dodd-Frank regulatory changes and consequences are not happening in a vacuum. The insurance industry is also facing other major regulatory changes including possible new domestic and international accounting standards, the imposition of bank-centric capital levels under Basel III, and the negotiation of Solvency II. Regulators have not taken into consideration the cumulative impacts of all of these initiatives, yet it is their interconnected nature that will determine how the insurance industry and economy will operate.

Failing to get this right will harm the insurance industry and American capital markets for the next generation.

Finally, the Chamber has supported the creation of the Federal Insurance Office. This allows the American insurance industry to have a unified governmental entity in the negotiation of international agreements.

The drafters of the Dodd-Frank Act sought to reduce risk following the 2008 financial crisis. However, risk, like energy, cannot be destroyed -- it can only be transferred. Reasonable risk taking is at the heart of our free enterprise system and to eliminate risk will also eliminate the entrepreneurial spirit that allows our economy to constantly renew itself and dynamically create wealth and jobs. Blindly transferring risk, without the requisite streamlining and reform of the antiquated 19th and 20th century financial regulatory structure, is merely fighting the last battle of the last war and planting the seeds for the next crisis.

In reviewing the Dodd-Frank Act two years later, policy makers must take into account the impacts upon the capital formation for the non-financial industry and ameliorate negative impacts. Failing to do so will consign the economy to anemic growth and the United States will not be able to create the 20 million jobs over ten years needed for a prosperous economy.

To date, nearly 10 different regulatory bodies have issued almost 9,000 pages of regulations, and that only completes 30 percent of the regulations mandated by the Act. No one knows the full implications of these new regulations on our economy. However, there can be little doubt that the burden and uncertainty of these new regulations will be a drag on our economy and job growth for years.

Thank you and I will be happy to take any questions that you may have.